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Logitech International SA (LOGI)

Q3 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Logitech's Third Quarter Fiscal Year 2017 Financial Results Conference Call.

At this time, all participants are in listen-only mode. We'll be conducting a question-and-answer session and instructions will follow at that time. [Operator Instructions] This call is being recorded for replay purposes and may not be reproduced in whole or in part without written authorization from Logitech.

I would like to introduce to your host for today's call, Mr. Ben Lu, Vice President of Investor Relations.

Ben Lu

Vice President-Investor Relations, Logitech International SA

Thank you, Sandra. Welcome to the Logitech conference call to discuss the company's financial results for the third quarter of fiscal year 2017. 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. As noted in our press release, we published our prepared remarks on our website in advance of this call. Those remarks are intended to serve in place of extended formal comments today and they will not be read on this call.

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 that could cause actual results to differ materially from those anticipated in the statements. Factors that could cause actual results to differ materially include those set forth in Logitech's Quarterly Report on 10-Q filed with the SEC on December 31, 2016 and subsequent filings.

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 includes a table detailing the non-GAAP measures, together with the corresponding GAAP figures and a reconciliation to GAAP. This information is also posted on our Investor Relations website. The slides that accompany this call are also available 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, and all reported results and updated outlook are focused on continuing operations and do not include the performance of Lifesize, which is reported under discontinued operations. This call is being recorded and will be available for replay on the Investor Relations page on the Logitech website.

Joining us today are Bracken Darrell, President and Chief Executive Officer; and Vincent Pilette, Chief Financial Officer. And 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. We just ended our seasonally biggest quarter of the year, and I'm excited to say that in retail sales, it was also our biggest quarter in company history.

We grew retail sales 13% in constant currency and our non-GAAP operating income – our operating profit grew 34%. We have very strong momentum across our business. And that growth was again broad-based with all regions and virtually all categories growing. And [ph] is this (03:19) explain to how we're delivering this growth, we were pleasantly surprised to be able to announce yesterday that we won the most ever GOOD DESIGN Awards 2015 with awards across every business area.

Now let's look at each of our key categories. PC peripherals grew 5% in Q3, about the same as the first nine months of the fiscal year. That's good momentum resulting from good innovation and execution. Keyboards & Combos sales rose 9%, marking the 11th consecutive quarter of growth and with consistent performance across all three regions.

Pointing Devices remained stable, up 2%. Our recently launched Silent Mice are quietly off to a good start and were a solid contributor, representing up to 10% of our Pointing Device business in certain markets. PC Webcams grew again at 4% as we saw a nice ramp from our latest C922 Pro Stream Webcam.

Our tablet and other accessories business declined 29%, in line with trends in the broader tablet market. We'll continue to innovate here to leverage our typing expertise and capabilities in this highly strategic space.

Video Collaboration sales rose 38%. We started to sell our SmartDock for Skype for business just at the very end of Q3. We've a terrific lineup across multiple price points and video collaboration, and are playing in a very robust market.

Our mobile speakers grew 25%. We're demonstrating that we can drive growth with innovation in this business, whether it's through our software capabilities, led in PartyUp, through the strength of our go-to-market strategy or through our product innovation itself. For the first time ever, mobile speakers topped the \$100 million in a quarter.

Jaybird contributed about 2 percentage points to our Q3 sales. We haven't even scratched the surface of its potential. The reception in the market of our newest X3 wireless earbuds has been very strong. Wired Magazine recently called them the best wireless earbuds you can buy.

BuzzFeed included them in their 24 of the best gifts you can give for Christmas for 2016. Unfortunately, our supply didn't keep up with the excitement. We're normally quite good at executing on supply. So, as you would guess, we have a plan to correct this situation.

We could have had even stronger quarter have we not had the shortfall. We're really excited about the future prospects of the wireless earbud category and our place in it. This is just the very beginning of our story here.

On the gaming, in gaming, the business grew 39% and continues to have terrific momentum. This was the sixth consecutive quarter of double-digit growth. Our Logitech Pro gaming mouse and our industry-leading wireless G900 mouse were strong contributors to the performance. We expect demand for PC gaming around the world to remain healthy going forward.

Our new Prodigy lineup aimed at first-time gamers are doing really well, and our premium gaming products should help us continue to grow against existing game product users -- gaming product users.

Now let me pass it over to Vincent.

Vincent Pilette

Chief Financial Officer, Logitech International SA

Thanks, Bracken. Hello, everyone. As the CFO, I'm just delighted by this quarter. The numbers speak for themselves. It is not a proof point that the business model we are building, combined with our strong execution, is delivering sustainably long-term growth on both the sales and the profit lines.

With sales up 13% year-to-date and with another broad-based performance across our regions, across our portfolio, we are strategically, methodically pulling our operation levers to accelerate our momentum. It is our highest ever sales, and combined with a continued focus on execution, we drove Q3 non-GAAP gross margin up 380 basis points to a better than expected 37.4%, a record.

As you know, typically, second half gross margin falls seasonally versus the first half due to holiday promotions. Our successful cost savings efforts, including the integration of cost management into our design framework as we discussed last year in March, more than offset the increase in promotion.

As a result, gross margin for the full year will trend slightly above 36%, 1 full point better than we expected at the beginning of the year. We are now in a great position to reinvest some of the extra gross profit dollars into our core capabilities, R&D, design, go-to-market, marketing, to deliver a model that can drive sustainable sales growth and capture the vast market opportunities in front of us. That is our focus. That is our priority.

Non-GAAP operating expenses were up 11% to \$150 million in Q3. If you exclude the additional OpEx from Jaybird, our non-GAAP OpEx would have increased 6%, a great operating leverage. We invest in R&D. It was up 10% in Q3. We invest in sales and marketing, up 16% in Q3, but we also continue to take down our infrastructure spend as demonstrated by the 3% decline in our G&A spending.

In fact, our G&A reached a record low level of 3.2% of retail sales and that was for you, Daniel. Our total non-GAAP OpEx to sales ratio was 22.5% in Q3 driven by this consistent effort to drive greater cost discipline.

On the cash side, we continue to deliver strong cash flow, with cash flow from operations of \$147 million in Q3. I read a few reports this morning indicating that cash flow from operations was down this quarter. In reality, we drove much smoother working capital through the year.

If you look at the first nine months of fiscal year 2017, our cash flow from operations was \$234 million compared with \$151 million in the same period last year, a 55% increase, and that's the right metric. Our Q3 cash conversion cycle remained very, very healthy at 14 days.

On the cash returns side, we repurchased \$21 million of stock in the quarter. That is in line with our capital allocation strategy, which as you know focuses on acquisitions, dividends and then stock buyback.

And with that, Bracken, I turn it back to you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thanks, Vincent. I told you at the end of Q2 that we would wait to revisit our guidance until we'd finished our biggest quarter of the year. So, with Q3 coming in better than expected, we're, of course, raising our guidance, and we now expect fiscal year 2017 retail sales growth of 12% to 13% on a constant currency basis, up from 8% to 10% in our prior target.

We expect our full year 2017 non-GAAP operating profit to be \$225 million to \$230 million, up from the previous target of \$195 million to \$205 million. Vincent and I and the whole team are building a special company, a company that can deliver consistently strong growth over the long term and it's built on five pillars: operational excellence, R&D, design, go-to-market and marketing. We'll give you more details around our outlook and our strategy in our upcoming Analyst and Investor Day, that I hope many of you will be at on March 7 in New York City.

And with that, Vince and I are open to take questions.

QUESTION AND ANSWER SECTION

Operator: [Operator instructions] Your first question comes from Ananda Baruah from Brean Capital. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Hi, Ananda.

A

Ananda P. Baruah

Analyst, Brean Capital LLC

Hey, guys. Congratulations and good morning. Hey, just a couple if I coul. Just going back to the game, really to start out, want to get a sense of how you guys are thinking about the growth drivers, entering the year, and if you could, I guess maybe kind of peel back what drove the strength in gaming this quarter and in mobile speakers as well. It seems like from a growth perspective, those are the ones that kind of really drove the growth this quarter. And I have a follow-up or two. Thanks.

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Okay. Yeah, I'd say – I'll just jump right into those two categories. Actually I'll add a third one, which is Video Collaboration. All three of those businesses grew very strongly, almost 40%, 25% and almost 40%. So you had three very strong performances.

A

The truth is all three of those are really built on just great product experience. And we continue to innovate, and gaming is a great example where our mouse business, we've done a great job of coming up with very strong products. We've also introduced a product line that's really aimed at trying to get first-time buyers into the gaming business because we know they're out there.

It's a big population of people who are ready to come in. When a 12-year-old, 13-year-old, 14-year-old, 15-year-old boy or girl wants to play gaming, today they're using an existing mouse and they're going to start migrating into these. So, that's been a good story for us and then the overall story of high-priced, premium-priced innovation in the gaming category has been good too.

Video Collaboration, it's really terrific. The best thing about this story is we hadn't even really gotten any substantial knowledge out of the SmartDock for the Skype for business that we just launched at the very, very end of the quarter. So, we're really optimistic about that going forward.

And then in music, the trend just continues. We kept innovating. We innovated with PartyUp. As many of you know, it's probably the best job of innovation we've done in terms of really promoting it and marketing it, and we believe it helped drive sales during the quarter as people wanted to have more than one because they could connect not just two, but three, four five up to 100 or 150.

So, I'd say across the board, Ananda, we really felt good about the innovation and the go-to-market.

Ananda P. Baruah

Analyst, Brean Capital LLC

Q

And, Bracken, I guess in that context, is there anything sort of in each of those categories that you will consider was – whether it's initiative or sort of upgrade cycle, new products introduced – that you will consider kind of net-net incremental to the product category that, number one, had a material impact sort of to – if not just to the category but to the selling experience?

And then I guess secondarily, in those categories, is there is there anything that you can talk about sort of in the marketing context, the go-to-market context or a new product or feature context in 2017 that will continue to drive growth in those categories. And I think we're just trying to get our arms around all the dynamics because there's a lot of – that you have a lot of stuff going on?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah. I could go through each one of them and talk about what features or benefits that we sold during the year that really helped propel the business in Q3. But a lot of those were also true in Q2, Q1 and Q4 the prior year. So, we're innovating all the way through the year as you know, Ananda, and this is our game plan. We're always going to be doing this.

In terms of looking forward, we obviously – we don't introduce products on the analyst cal. But what I can tell you is I feel very, very good about our invasion pipeline coming into next year. I'm as excited or more excited than I've ever been about it. So, I think we're in a really good position.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

And, Ananda, this is Vincent. If I can add, when we look at the growth across three drivers, the market growth itself, our new products and then the expanded distribution, we grew across all those three, and that's the dynamic that we expect to continue in FY 2018. And then for more details, I'm sure I'll see you in March at the Analyst Day.

Ananda P. Baruah

Analyst, Brean Capital LLC

Q

Absolutely, guys. And one quick one for me and then I'll [ph] gallop in here (15:38). So just the keyboards and desktop category, grew 8%, so it's sort of been double-digit-ish, let's call it, but off of like you know it's like a 2% compare. So, it's holding this like high-single-digit, double-digit level for the last couple of quarters.

So, if the compares start to get a little bit more tough, but could you just sort of talk to the dynamics that are sort of driving that double-digit-ish kind of growth? And because it's such a big part and a high-margin part of the portfolio, can you just sort of level step what our expectation should be for calendar 2017 on that? Thanks.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah. I mean, it all starts with the installed base. There's a lot of – the number of PCs out there is relatively flat and has been for years. So, the installed base is in its aging. So, you've got a lot of people who can upgrade their PC with a keyboard, and we've innovated there and we're going to keep innovating there.

So, the latest innovation we did, we started really a little over a year ago, year and a half ago was to bring multi-device, so meaning you could connect multiple products at once. It's also just really easy to connect those keyboards. So, that's helped drive the innovation. And we've got more in store coming up in the next few years.

So, I think the keyboard is alive and well, and I don't think there's anything that's really replaced it yet for productivity, and I expect it to stay that way for as far as I can see into the future.

Ananda P. Baruah

Analyst, Brean Capital LLC

Q

Okay. Great. Thanks a lot.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thanks, Ananda.

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

Jörn Iffert

Analyst, UBS AG

Q

Yeah. Hi, gentlemen. Thanks for taking my questions. The first one would be on the medium-term model. You're guiding for 35% to 37% gross profit margin, but given the progress you're making, given the better scale in audio, gaming or other categories, don't you think this is a [ph] take to conservative (17:31) and we can expect an adjustment in March for these targets?

Second question would be if you look at your categories, do you see the risk of any slowdown on majoring end markets like in wireless speakers or in gaming for the next 12 to 24 months? And just [ph] exactly where are we in the cycle (17:48) in these categories?

And the last question would be if you must split your growth for Q3, what was generated with the new customers and what was generated in existing channels? Thanks very much.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Okay. Let me before – I'll let Vince answer the gross margin question. I'll jump in on the second one first. Do we see anything in the end user markets that would suggest a slowdown in either Bluetooth speakers or in gaming? I think first of all, as we said, I think in the gaming business we see very robust dynamic underneath that. I don't see anything changing. I think in the Bluetooth speaker business, there's been a lot of discussion around Amazon Echo and it's a fact that I think the truth is the markets are really for them, we continue to perform within it. And we will have – I'm sure we'll have categories that will change their trajectory. And the whole point of the equation we're building here, the strategy we're building here is we're going to be in more and more categories and we're going to manage the ups with the downs.

I have no expectation that Bluetooth speakers are going to go down. I think we'll continue to have good growth in the next year. But if it did, we'd be fine. We're going to grow in other categories. You want to talk about the margin point, Vince?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah. So, Jörn, as you were asking the question, I was thinking nine months ago when we raised our gross margin target from 35% to 37%, I would not have expected someone to say that, hey, that's a conservative range. But we are where we are with great results in our cost savings.

A 100% of the margin improvement is coming from cost savings, and we expect that to be sustained. If you look at the full year gross margin, slightly above 36%. Before we change any long-term guidance, we want to be sustainably and demonstrate we can sustain the margin in that range.

And then from a modeling perspective, I would invite to really look at two key drivers. One is and is the number one term of priority is the growth, right, the growth of our sales. When we looked at all of our opportunities, that's our focus.

And the second one is the bottom-line operating margin. We raised it last year from 10% to 10% to 12%. This year guidance would imply 10.5% of operating profit margin, and we'll continue to move towards the high end of that range.

When it comes to gross margin, it is our objective to try to hold gross margin as high as possible because that creates investment capacity to invest into more categories, as Bracken mentioned, into addressing all of the market opportunities we have. There are many drivers, as you know, including currency and others, that will have some fluctuations on that margin. But our focus is on the top line first and then the bottom line margin second.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

And I love your question on new users and I'll try to answer it a couple ways. So first of all, if you step back from the picture, we're gaining market share in most of our categories. So, that's a good story, but it doesn't answer your question.

Now let's go – I'll just pick out two categories. Video Collaboration. We just keep building new users and big company names, small company names, medium-sized company names, all of them going into the array of small and medium-sized rooms that are going to become video-enabled. And you talk about being early in a story. This is a very early story for Video Collaboration. So, yes, we are absolutely – that is all about new users, new users, new users, and we haven't -and we've got a lot of – we just scratched the surface of how many are out there.

In gaming, I mentioned it in the script, but and we introduced the product that's really targeted at bringing in new users who play video games but don't yet use gaming products, which are higher-performance products. And that new prodigy line up we were selling is doing very well, which implies that we're bringing in new users there.

I think it's probably safe to safe across the board, except for perhaps in some of core categories where we started, that we're bringing in a good mix of new users, probably a disproportionate mix of new users into this growth.

Jörn Iffert

Analyst, UBS AG

Q

All right. Thanks for this. Just one follow-up, Bracken, for you. You as a CEO, what is your largest concern for the next 12 months?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

It seems like everywhere you go, when you're in my job, you always get that question. First of all, I sleep well at night. I'm sure you don't care, but I do, and I don't have a large concern on anything. I'm generally paranoid about everything, and so I never relax on any single point. But if you ask me what's my biggest concern is, we've been performing very well. We just need to make sure we keep the entire company super hungry because the world's changing very fast and we have so many opportunities that there is no excuse for us not to get them.

Jörn Iffert

Analyst, UBS AG

Q

Thanks very much.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Okay.

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

Jürgen Wagner

Analyst, MainFirst Bank AG

Q

Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hey, Jürgen.

Jürgen Wagner

Analyst, MainFirst Bank AG

Q

Yeah, hi. Thank you for taking my question. You touched on the gross margin, can you walk us through the dynamics in Q3, how much of the increase year-over-year or quarter-over-quarter was driven by volume mix, price or FX? And then I would have a follow-up.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah, that's very little from mix and actually it's a very simple dynamics in Q3, and the year-over-year gross margin improvement is cost savings improved gross margin more than what we reported, and that is partially offset by increased promotion as we were very active in the market pushing out our sales and addressing the opportunities.

So, that's the dynamics. Within the cost savings, obviously, there are a few different things. One is higher volume, right, enables you to do many different things, amortize your overhead cost on the higher volume, better negotiate with your providers.

And then the second dynamic within those cost savings is as we discussed last year, integrating cost management as part of the design framework and having new products being introduced at a higher gross margin that we used to have in the past, and those led to the dynamics you see on the gross margin side.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah. I'll just hit that point one more time. Integrating design into the creation of a product is something that it's actually a big deal because we used to – think of it, we used to really – one team would launch the product and another team would run in and try to take the cost down, and we did a pretty good job at that. And we're still doing that. But we have a big opportunity to push that upstream and have both those teams working together hand-in-hand to take – to launch at a lower cost in the same or better experience. So, that's really what Vince is talking about, he's talking about moving into the design cycle for cost.

Jürgen Wagner

Analyst, MainFirst Bank AG

Q

And thanks for that. And in some countries where you are quite strong, you saw the FX movements. So the question here is, have you raised prices in those countries that were the most affected by FX moves?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

So just a little bit of history, right? In 2015, when the U.S. dollars appreciated, we did raise price and took about four to five months to fully recover from a currency impact. At the time, we had said we would do another price increase if the euro goes to parity. We put that at the time in 2015 on the shelves, and we always be ready to look at opportunities to raise price where it makes sense when it's currency-driven. So, that's what we keep working, and we'll have that as a lever in place as we go in to FY 2018.

Jürgen Wagner

Analyst, MainFirst Bank AG

Q

Okay. But you haven't done so in Q3?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

No.

Jürgen Wagner

Analyst, MainFirst Bank AG

Q

Okay. Thank you.

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

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hi, Paul.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Yeah, I'm wondering if I can – hi, Bracken. Hi, Vincent. Congratulations. I'd like to turning the subject to the exciting matter of taxation. Can you just give us a quick update on what's happening in your domestic market in terms of corporate tax and whether that's something we should be factoring into things longer term. You're welcome to comment on the U.S. kind of border tax, border adjustment and what your strategic response might be, where that's to proceed as well?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Okay. I will let Vincent take the tax, the first taxation. I'll take the second.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah. So, quick for everyone right, so tax rate currently for the year between 9% and 10% at this level of profit and current mix assumption. We're a Swiss company. We are subject to the tax Swiss flows and then the normal international transfer pricing rules. There is a tax reform that is in the kitchen if you want to [indiscernible] (26:40) in Switzerland for 2019. It's too early yet to speak exactly what it will mean, but for the short term and for FY 2018, we don't expect any change from that perspective.

And then I'll refrain myself from speculating on other tax speculations. I've seen many. We read a lot. I would just point to the fact that we have a global supply chain. We're distributing in every country. We continue to automate and make our supply chain more flexible. And we'll monitor the macro level and react appropriately focusing on shareholder value.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Perfectly said. I wouldn't add a thing to that.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Okay. Thank you. And then, Bracken, on the – we're seeing a lot of interactive speakers, big institutions to market, obviously, Google Home and Amazon Echo being the most prominent. Is this a strategic threat? Is it a technical opportunity? Perhaps you could just give us some color around that segment of your market and whether it impacts your speaker business?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I think it's a really interesting moment. I mean, I think there are different ways to look at those new personal systems that are coming into the home. But I think generally speaking, you would expect me to say, I view that as an opportunity. I think they're generating opportunities for us around them and through them.

So, you may have seen that in the speaker business itself, you saw we had a very strong quarter in Bluetooth speakers, and we've got a lot of innovation planned ahead. So, we're excited about our business there in that category.

But we're also excited about what those platforms can enable in other parts of our business, which you'll see in the future if you haven't already. So, one of them you have seen is in Harmony, we paired that with Alexa and the result of that is we really saw a good strong sales growth coming in Q3 on hub-based products, and it was sustained all the way through the quarter and beyond. So, I think these are just great opportunities for us. Remember where we come from, Paul, we're a mouse company. We were built-off of Windows and the Mac and those operating systems. When we look at everything, our orientation is to look at anything as a new platform that we can build things around, and absolutely that's the way we feel about personal systems.

Paul Coster

Analyst, JPMorgan Securities LLC

Q

Great. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thanks, Paul.

Operator: Your next question comes from Andrew Humphrey from Morgan Stanley. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hey, Andrew.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hi, Andrew.

Andrew E. Humphrey

Analyst, Morgan Stanley & Co. International Plc

Q

Hi there. Hi. So just one left from me, I think, and without wanting to kind of preempt anything from March, clearly you've seen pretty strong progress on gross margins and some organic OpEx growth this year. You've talked about using that strength in gross margins reinvest in R&D. Can you give us an idea of what sort of ballpark OpEx growth we could expect for FY 2018 assuming, I guess, the midpoint of your long-term revenue growth plans?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah. So, let me take that, right. So, the exact guidance for 2018 we're not giving it, right. We'll give it March. We are obviously discussing planning and working inside the company to get ready for March. We have our long-term model, a high-single-digit growth rate today in place, a gross margin target of 35% to 37%, an OpEx down to 25% of sales and an operating profit 10% to 12%.

As I mentioned, priority one is growth rate, priority two is improving the bottom-line profit margin, 10% to 12%. We're now at 10.5%. From an OpEx perspective, we'll continue to improve the expense-to-sales ratio marching towards that 25%. So, you should expect overall OpEx to grow slightly less than revenue.

Now on buy line, obviously we'll invest in R&D. I think we are right there. So, keeping R&D in line with revenue growth seems to make sense and then we'll have other movements in that investment. More in March, but just to give you some data to model your projections.

Andrew E. Humphrey

Analyst, Morgan Stanley & Co. International Plc

That's great. Thank you.

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Thanks, Andrew.

A

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

Hi, Tavis.

A

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Hey, guys. Thanks. Hey, Bracken. Hey Vincent. Great quarter. I think most of the meaningful questions have been asked. I had a couple of follow-ups or minutiae here, Vincent. On your slide on the guidance for the rest of fiscal year, you're still holding to a \$50 million CapEx that would obviously imply a pretty big ramp in Q4. Is there some specific project that's related to or should we expect CapEx to probably come in below the guidance for the year?

Q

And then secondly, as we look towards March, I know almost every day currencies are changing good, bad and otherwise. As far as you can tell right now, what should the delta be between reported retail sales growth and constant currency retail sales growth for the March quarter specifically? Thanks.

Vincent Pilette

Chief Financial Officer, Logitech International SA

Yeah. So let me take both, and CapEx quickly, as you pointed out, right, we guided for an annual spend on average of about \$50 million. The range, frankly when you look at history, is between \$45 million and \$55 million around that range. Last quarter we said will be trending towards the bottom of that range.

A

Year-to-date, you see on our cash flow statement \$23 million spend in one quarter to go. So, it's fair to assume that we will be below the lowest point of that range, so below \$45 million. The only thing I would point out as you model multi-year, right, is that we've spent a little bit more CapEx but we also aligned the payment of some of those contracts to the deliverables, so to milestones, if you want.

So, while we may only report a \$40 million spend in CapEx, we actually committed to \$45 million more for the year. That's currently the range. We normally don't guide, but that gives you enough indication of where we are trending.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

And I wouldn't view that as a new normal I think.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

No. I think again if you do multi-year trending, I would keep the \$50 million as the right point and some year will be below like this year. Last year we had \$55 million or \$56 million until we are higher. The second point on currency, right, we learned a lot in 2015 around the currency impact and the pricing environment and the different levers we have in our P&L. And if currency continuing the trend with U.S. dollar appreciation, we intend to use all of our levers to pull and address the situation.

When it comes to Q4 itself, there is a lot of volatility, right? A week ago, the dollars, the difference [indiscernible] (33:22) actually today, we factored all of our hedging and currency at around 105 for the USD-euro translation for Q4, and that will be about the range. So, you should have one or two points deltas in that quarter if currency stays where it is today.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

Great. Thanks. That's very helpful.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Tavis, we've had a couple of questions on currency. I want to just go back to the comment Vincent made earlier. The one good thing that – we're in a better position now than we were two years ago because we went through two years ago a big currency impact. So, we had to adjust and we learned how to do pricing in places where we hadn't done it. So, I think we're in a good position to manage this. It just depends on how quickly where they flip. But I think over a reasonable timeframe, we can adjust to whatever currencies hit us.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah.

Tavis C. McCourt

Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

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

Hi, Michael.

A

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Yes. Hi, gentlemen. I had one question regarding Jaybird. I just wanted to understand what supply chain issues specifically you had and whether they are already solved or not and what you have to do to solve them?

Q

And the second question would be in EMEA the mobile speakers seem to have performed extremely well. You were mentioning, I think, a better penetration of distribution channels. Can you be more specific? What did you change in EMEA in the distribution channels and what made for the success of mobile speakers there?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Yeah. First of all, in Jaybird, what was the nature of the supply chain issue? Frankly, we just didn't get as much production as we needed. We could've had significantly better sales than we did. And without getting into too much granular detail on that, do we have a plan in place to address that? Absolutely. So, I think we'll be in good shape as we get through Q4 and into next year, yeah, I think we'll be in good shape on Jaybird supply.

A

And then we'll be back in the game of what we're really excited about, which was innovation, and we've got great stuff out there and great stuff coming.

Yeah on EMEA Bluetooth speakers, it's really a story – I think all the numbers are in EMEA but I think we finally grew market share again in EMEA. We had a really strong quarter. It wasn't just a distribution game story. It was really a performance within the distribution we're in.

And I think that's a result of very strong innovation, and we have very strong innovation ahead. So, I feel good about our Bluetooth speaker business. EMEA was a great performance again, and I have no reason to think that we won't continue to have good performances there and take whatever is out there to get.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Okay. Great. Maybe just two short follow-ups. On the Jaybird products, do you produce them in-house or are they produced externally?

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

We do not. We do not produce them in-house.

A

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Okay. And that won't change?

Q

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Well, we're not planning to change that. We don't plan to produce them in-house. Well, we may at some point. But as you know, we make about 60% to 65% of our products in-house. That's probably higher than we'd like. And somewhere between 50% and 60% is probably a good number, but we don't produce them in-house.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Okay. And then just on gaming, you mentioned the strong performance of your high-end products. How have ASPs in the gaming category changed over the last 12 months?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I don't have that in front of me. We could follow back up with that. I think overall the good news in gaming in general has higher ASPs than the rest of the core business. It's the mouse, looks like the mouse keyboard. So I think in general, the thing I'd point to is really blowing it out and relatively speaking in the G900, which is a wireless gaming mouse. It sells for – the MSRP is \$149, which is the highest-priced mouse you could buy. So, I can go take a look at it, but I would guess our overall mix, our overall ASP is on its way up.

Michael Foeth

Analyst, Bank Vontobel AG (Research Firm)

Q

Okay. Great. Thank you and congratulations.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Operator: Your next question comes from Andreas Müller from ZKB. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hello, Andreas.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hey, Andreas.

Andreas Müller

Analyst, Zürcher Kantonalbank

Q

Hello, everybody. Thank you very much for taking my question. I was wondering, what is your view on the potential of integrating voice control also in the PC product categories? How significant would that drive growth in your P&L or is it significant or just and as each of them continue with [indiscernible] (38:02) single-digit growth overall in the PC categories?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

It's really hard for me to say. I mean, that's probably a better question for the PC makers. I think voice seems like – voice has really worked extremely well in the home and it's early days there. And I'm sure that with Cortana and other things there will be more and more voice in offices.

So, I would expect you'll see more of that. It's a little tricky, but I would expect to see more of that. I don't think that will negate the need to be able to input what you're thinking or respond to what you you're saying in a way that it is not voice-related because you're in an office with – and increasingly an open office. So, that's why I think the keyboard business will be healthy. And the pointing device especially for people working on productivity and spreadsheets and things, you just need it.

But I don't know, I think time will tell. I think we're all very excited about voice ourselves, and I don't think you'll see a revolution anytime soon in the office, but you never know. And so we'll be ready for something.

Andreas Müller

Analyst, Zürcher Kantonalbank

Q

Okay. And on Jaybird, does this change anything on the earnout payments or is that simply because it's out of your control, not really an issue ojn the earnout payment?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hey, Andreas, let me address that, right. So first, let me tell you that it's our objective and it's hard to pay the entire earnout because it would be a fantastic growth rate. Every time, every quarter we are forced to – by the accounting words, right – reevaluate the probability and the value of that earnout on our balance sheet. And because we had a forecast gap, if you want, or didn't deliver to the full potential in this quarter because of the supply chain issues, we had to reduce that forecast, and that reduced the value on the earnout and the balance sheet.

So, you've seen a reduction of about \$10 million that hit the gap P&L non-cash item that reduced that balance sheet item. That's the current view every quarter. We'll review that and you'll see some fluctuations in that earnout based on how the forecast evolves over the next remaining, what now, 15 months.

Andreas Müller

Analyst, Zürcher Kantonalbank

Q

Okay. Thank you.

Operator: [Operator instructions] Your next question comes from Günther Hollfelder from Baader Helvea. Your line is open.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Hi, Günther.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Günther.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Hi. Thank you. Just two questions left on the sales performance. Can you provide some additional color on your strong performance in Europe from a country prospective?

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Yeah. It was very broad-based. That's the fun thing to talk about I, boy, really just broad-based. You can almost pick any country in Europe and you've got a good story to tell. So, we're just performing very well in Europe.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Okay. Great. And the second one on the sell-through from a product perspective, is there anything you want to highlight from a product perspective? Were there any delta compared to the whole group or regions?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

No. Overall, if you look at by region, sell-through was fairly aligned to sell-in, which is great, actually slightly higher, which is even better. We finished in a good position. There was one noticeable event, of course, is the sell-through on Jaybird was extremely strong but our sell-in was very poor because of the supply issues. So, that's created a disconnect in Americas.

And there are always pockets of rebalancing, if you want, by category, by region, but it's all factored into our raised guidance for Q4. We feel really good about our guidance as we finish the year. By category, across Q4 you may have slight adjustments, but nothing noticeable at this point.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I would just add. We have pretty good visibility into how much we have in the channel and where it sits. And it's probably the best visibility we've had, certainly miles better from where we were five years ago. So, we feel, as Vincent said, we feel very good about the sellout. It looks good. It looks very, very aligned with what we're reporting from a net sales perspective.

Günther Hollfelder

Analyst, Baader Bank AG

Q

And you had quite a delta from a regional perspective from the Americas. You just mentioned one of the reasons was Jaybird. Any other product category you want to mention in the Americas context?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

No. And I would also always caution that, right, that we report the gross rate, the gross rate on sales auto, sell-through versus the sell-in. You also have to factor the base which you don't have in, et cetera. So as long as it's in line within a few points, you should feel good as a good indicator, but don't translate it one-to-one. The main driver in the U.S. was Jaybird and then there are many other little factors here and there, but nothing isolated outside of Jaybird.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

I think his questions was a bigger picture question, which is the growth rate there is lower than the growth rate in other regions. Is there any story there that we want to talk about? I think the answer is not really. I mean, I think you have cycles where one region outperforms another one, and then fortunately, because we have three regions and a lot of countries within each region, you tend to have enough diversity that they tend to balance each other pretty well. So, I would guess that over time, you'll see the Americas come up and others soften a little better or everybody. So, no, nothing that I would really highlight.

Günther Hollfelder

Analyst, Baader Bank AG

Q

Okay. Great. Many thanks.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Sure.

Operator: Thank you. It appears that there are no further questions. At this time, I'll turn the conference back over to Mr. Darrell for closing remarks.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

Great. Thanks, everybody, for listening. It's been – it was a strong quarter. We're very excited about the performance, and we are excited about the momentum. We've been doing this now -those of you who have been here the whole time, most of you have – for almost five years, and you've heard me say many times I was very excited about the road ahead. But I can tell you that never in my time here have I been more excited about Logitech's future than I am right now.

I hope many of you will make it to the Analyst and Investor Day. I think it will be a great day in New York, and we can share a little bit more about why like I have such enthusiasm in New York in March. So, thank you, guys, very much and we'll talk to you then.

Operator: That concludes our conference call for today. You may all now disconnect. Thank you.

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