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# Logitech International SA (LOGI)

Q3 2018 Earnings Call

## CORPORATE PARTICIPANTS

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## OTHER PARTICIPANTS

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good morning. My name is Kelly and I'll be your conference operator today. At this time, I would like to welcome everyone to the Logitech Third Quarter 2018 Conference Call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. [Operator Instructions] Thank you. Ben Lu, Head of Investor Relations at Logitech, you may begin your conference.

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Benjamin Lu

*Vice President-Investor Relations, Logitech International SA*

Thank you, Kelly. Welcome to the Logitech conference call to discuss the company's financial results for the third quarter 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 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 a non-GAAP basis except as otherwise noted. 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.

Now, joining us today from Lausanne are Bracken Darrell, President and Chief Executive Officer; and Vincent Pilette, Chief Financial Officer. I'll now turn the call over to Bracken.

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## Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Thanks, Ben, and thanks to all of you for joining us. You've all seen that we delivered a powerful quarter of sales growth, our biggest sales ever; up 18%. Demand for our products in Q3 was very strong, significantly stronger than we anticipated. All our product categories delivered double-digit growth, except for PC peripherals; and even in those, sell-through remains stable. Two of our three regions, America and Asia-Pacific grew over 20%. EMEA sales were only up 2% against a tough competitor, but underlying sell-through was also strong in line with normal seasonality. Our operating income growth was also just as strong, up 18%. We delivered that net sales and profit growth despite the drag on our ability to execute.

During our Q2 earnings call, we mentioned the difficulties we'd experienced transitioning to a new logistics supplier in the Americas. We had to run two distribution centers instead of one, as well as significantly increasing our air shipments; largely, because the one we were trying to exclusively move to, just didn't execute. The 2 DC backup plans coupled with our determination to fulfill the demand from our customers placed a drag on our gross margin of about 150 basis points in the quarter. This is largely resolved now and will be fully resolved as we exit the fiscal year. So, let me be crystal clear. Yes, we had a supplier who didn't deliver. Well, we hold ourselves 100% accountable. Investors should be able to rely on us to pick the right players and make sure they execute.

How did the growth look by category? As I mentioned, we grew double-digits across almost all of our categories. Let me highlight each one. Last quarter, you remember our Mobile Speakers went through a product transition and of our new Ultimate Ears BLAST and MEGABLAST and in time for our holiday quarter. This quarter, our mobile speakers group grew 34%. We sold in our Alexa enabled BLAST and MEGABLAST, but we also grew strongly in other products from our large MEGABOOM to our pipe size WONDERBOOM. That's doing well beyond our expectations.

I don't expect that level of growth to continue in the next quarter, but sellout was also very strong. Audio, PC and wearables sales grew 21% in Q3. Jaybird posted a strong growth this holiday quarter with good contribution from Jaybird RUN, our first true wireless earphone, and from our other product lines, like the X3 and Freedom 2.

Wireless earphone penetration is still very low. There's a long runway for growth here, as we will carve out space and continue to innovate. As a runner, I absolutely love and use our Jaybird RUN product.

Our gaming group delivered its 10th consecutive quarter of double-digit growth with sales up 57%. We have completed the integration of ASTRO Gaming and that business grew powerfully in the quarter two, representing 4% of our overall sales.

I've pointed out that ASTRO is heavily skewed the December quarter, and for the full year, we still expect ASTRO to contribute about two points to our overall growth. Even excluding ASTRO, our gaming business grew strongly than it has in the past several quarters. In Q3, our steering wheels business was particularly strong and we captured share at several major racing game title launched.

We also continue to see tremendous acceptance of our wireless gaming products across both mice and keyboards. You heard me talk last quarter about POWERPLAY and I had trouble stop talking about it. Our wireless charging pad gives infinite battery life for your wireless gaming mouse while you play.

Well, I can tell you the demand for POWERPLAY far exceeded our supply. We're the leader in wireless PC game peripherals and you can be sure that we'll continue to innovate and drive greater wireless adoption across our gaming portfolio, similar to what you've seen us do in traditional PC peripherals.

The new collaboration reported sales growth of 25%, reaching an annual run rate of approximately \$200 million or almost \$200 million. While the net sales growth was slower than last quarter, the underlying sell-through is much stronger than the 25%. The fundamental need for low-cost, cloud-based video collaboration solutions remains extremely robust and we'll continue to invest into this business to capture the growth opportunities.

Our smart home group continued the strong momentum that we've seen in the past few quarters. Sales in Q3 grossed 41% driven by both our Harmony Hub family of products, as well as the solid contributions of Circle 2, our home security camera solution. Finally, PC peripheral sales were down 4% this quarter, yet sell-through, as I mentioned, remained very stable and consistent with our recent trends.

Our latest products, including our new flagship keyboard, MX CRAFT, and our new trackball, MX ERGO, are off to a great start and contributed nicely to our results. Tablets & Other Accessories' sales grew 5% in Q3, marking the third consecutive quarter of growth. But likely in this fiscal year of double-digit growth and first full year of positive growth in the category since fiscal 2014, coinciding with the return to growth in Apple's iPad units.

Now, I'll pass the call over to Vincent.

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## Vincent Pilette

*Chief Financial Officer, Logitech International SA*

Thanks, Bracken. In Q3, we delivered our seventh consecutive quarter of double-digit growth. We delivered not just another quarter of consistent top line growth but, as Bracken mentioned, and it's worth repeating it, we gained sharing our key markets. We launched products into adjacent categories; BLAST, MEGABLAST, RUN. And we successfully accelerated the performance of our acquisitions.

We delivered on every one of our growth levers, playing in growing markets, growing our market share and adding entirely new market opportunities. That is our playbook including acquisitions.

Q3 was the first full quarter of ASTRO, which gained great market share in this highly seasonal business and made up 4% of our total sales in this past quarter. We are investing in our capabilities to take advantage of the many market opportunities, and Q3 growth of 18% demonstrated the progress we are making towards our long-term objective.

Now, growth sometimes comes with growing pains. As we mentioned last October, the third-party distribution center that we had hired in the Americas to support our growth experienced significant changes in the transition,

operating procedures, and ramp-up of our volumes at the end of Q2 and early Q3. As a result of this, we had to bring back online our prior DC partner, increased temporary labor, and rely on air freight much more heavily.

Our priority was to support the 30% increase in demand that we saw in the Americas. The one-time incremental costs of solving this operational issue amounted to about 1.5 points of gross margin. Now, with Q3 behind us, we will exit this fiscal year back to just one third-party distribution center in the Americas.

And so, our non-GAAP gross margin was 34.4% in the quarter, down 300 basis points year-over-year. Excluding the one-time cost of our DC transition, gross margin would have been around the midpoint of our long-term gross margin range of 35% to 37%. It remained very healthy in what is normally a seasonally lower gross margin quarter impacted by mix and holiday promotions.

In Q3, our non-GAAP operating expenses increased 8% to \$162 million, and were 20% percent of sales, down 250 basis points year-over-year. Excluding ASTRO, our operating expenses would have risen only 4%. This modest OpEx growth demonstrates our discipline in balancing our near-term spend with gross margin.

Our sales and marketing expense increased 14% to support the solid top line growth we delivered this quarter while R&D spending grew 5%. On the other hand, we continued to drive our G&A expenses lower as efficiently as we can. Our G&A spending as a percent of sales fell to the lowest level ever at 2.2% of sales, although this ratio of course benefit from the strong seasonal pickup in revenues.

So, if you step back, Q3 sales was 18% in constant currency while non-GAAP operating income also grew 18% despite the one-time operational challenge of our distribution center in America. Excluding this, our operating profits could have grown by 30%.

A strong quarter and what we expect will become a very strong year will not be meaningful without strong cash flows. On that front, we generated \$189 million in cash from operations this quarter. It is the highest quarterly level we ever achieved and this compares to \$149 million of cash flows in Q3 of last year.

You will remember that we have said we would consume working capital during our first half as we built up new products and prepare for strong holiday season. With our new product successfully launched and our sales achieving a record level in Q3, we reduced the inventory around 50 million sequentially and we achieved inventory returns of 7.7 times, the highest level since I've joined. In the past four years, our December quarter inventory returns had average 6.6 times.

And in this quarter, our cash conversion cycle remained very healthy at 14 days. As a reminder, our cash conversion cycle is typically the lowest in the December quarter due to seasonality. On a full year basis, we still expect our cash conversion cycle to be within our targeted annual range of 20 to 25 days.

One last thing I would like to add and that's around the GAAP profitability. As most of you are aware, the U.S. passed new tax laws at the end of December that reduced the U.S. corporate income tax rate as of January 1. And, as a result, we are required to record a one-time \$60 million net tax expense in the December quarter, which is our Q3, related to the implementation of the U.S. federal tax reforms, including the necessary re-measurement of our U.S. deferred tax assets at a lower corporate tax rate.

In summary, Q3 marks another strong quarter of growth, profitability and strong cash conversion. And the most exciting for me, as the CFO, is that we still have plenty of room to execute better and continue to grow and expand.

And with that Bracken, I'll pass it back to you.

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## Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Thanks, Vincent. We finished our biggest quarter of the year with very strong top line growth and strong profitability and cash flow as Vincent said. We're continuing to build on our multi-category, multi-brand strategy.

And finally, as Vincent mentioned, you can see completely transparently all three of our growth drivers in action this quarter: market growth, shared growth within the markets and new adjacencies. And, I think, you see from the level of growth, the power of the strategy applied to our markets. So, we have lots of opportunity here.

Based on our results, we're raising our fiscal year guidance. We now expect fiscal year 2018 sales growth to be 12% to 14% in constant currency and non-GAAP operating income to be \$270 million to \$280 million.

And with that, Vincent and I are now ready to take your questions. Operator, can you queue up the questions.

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## QUESTION AND ANSWER SECTION

**Operator:** Certainly. [Operator Instructions] Our first question comes from Joern Iffert from UBS. Please go ahead. Your line is open.

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### Joern Iffert

*Analyst, UBS*

Q

Hi, gentlemen, and thanks for taking my questions. The first one would be please, on the product pipeline, you have and had for the next 12 months. Can you give us an indication of which categories, innovation rates will be the highest and also what is roughly the number of new products introduced in fiscal year 2019 versus fiscal year 2018? Just to give a rough indication would be helpful.

The second question would be the currencies are developing favorably for you? I mean is the new euro, U.S. product exchange rates the key reason for the non-GAAP EBIT increase?

Third question would be, on EMEA and sell-in plus 2%. Can you give us some more indications what is happening on the channel here?

And the last question would be please on the gross profit margin and development. I mean FX becomes supportive, you still have to [ph] design to cost program in place (14:46). How shall we think about gross profit margin momentum going forward here for the next couple of quarters? Thanks very much.

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### Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Okay. Thank you very much. Vincent and I will split this. He'll take the currency, gross profit questions. I'll take your first and last. Because on innovation pipeline, yeah we're an organic innovation company; we do acquisitions where we're fundamental in organic innovation company. So, we're in a constant state of creating new products

all the time. When we launch one product, you probably could guess that we're already underway on a second product.

So, in terms of the absolute number of products we launch every year and in which categories those go into – in terms of the absolute number, year-over-year, our launch number is probably irrelatively comparable, but we don't look at it that way. We really look at making sure that we continue to evolve our product lines and enter new spaces where they should be. So, I couldn't be more specific than that, and I apologize for that. But we have certainly planned to have a great pipeline of innovation ahead.

In terms of the specific areas, we generally innovate as you can see in every area that we're in. So, we break our company into small teams. These small teams wakes up in the morning, goes to bed at night trying to figure out how to build a bigger business and create and design better products for consumers. So, you're going to see innovation as you have in the past across everything.

The second question on India. Yeah. We had 2% sell in. And as we said, our – the underlying sales out or sell through was significantly higher than that and we've said that the last couple of quarters. Yeah. They are adjusting to a lower growth rate at very high growth rates in a year ago, as you know, in the 18% to 21% range over the past three or four quarters, and you see that adjustment happening. It did take inventory out of the channel to adjust for that lower sales rate including in this quarter. And I think you – we'll see that adjustment really be completed as we finish the year.

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#### Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hey, Joern. On currency, as you mentioned, the U.S. dollars conversion rate is moving favorably to us. What's always changing is when we have volatility within one quarter. As you know, we do hedging on the four months rolling forecast where we discussed it many times on the call and we also buy our inventory a few months in advance, right?

So, this quarter if you take as an example, we had the euro, USD change of about 6% to 7% year-on-year that create about 80 basis point favorable in the P&L, half a point what hedging costs neutralizing that benefit. And so, we have the same going into Q4. At this point in time, if the exchange rate for the year-on-year, this stays at 122 basis points. We have another move of 6%, 7% and hedging cost will be absorbing over half of that impact. In the long run though, you're correct that if currencies stay where it is, it will be – it will be favorable on our gross margin.

So, talking about that gross margin. Excluding the DC issue, we delivered 18% top line growth for 36%, rounding 35.9%, but 36% gross margin. We will always balance, as you know, investment versus dropping everything to the bottom line and really prioritizing our focus on growing our businesses that have growth opportunities.

At this point in time, we're not guiding next year. As you know, that will be during the [ph] AID (18:05) event in March. But we stick with our range, 35% to 37%, and our goal is to try to generate the highest gross margin like last year in FY 2017, over 37%, to be able to continue to invest into our businesses.

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#### Joern Iffert

Analyst, UBS

Q

All right. Thanks very much.

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Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Thank you, sir. Next question.

A

**Operator:** Your next question comes from Asiya Merchant from Citigroup. Please go ahead, your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Hello there.

A

Asiya Merchant

*Analyst, Citigroup Global Markets, Inc.*

Oh, Great. Hi. Congratulations. Excuse me.

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Thanks.

A

Asiya Merchant

*Analyst, Citigroup Global Markets, Inc.*

Quick question. If you can just talk about seasonal trends going into the fiscal 4Q and which product category do you feel very comfortable about in terms of seasonal trends? Gaming, obviously, was a blowout quarter for you this particular quarter that you just reported. So, how should we think about the March quarter?

Q

And then, I had a follow-up on cash per share, pretty high at this level. How's management thinking about deploying that cash? Whether it's capital return or should we be expecting, again, some more seasonal – some more acquisitions in looking into your fiscal 2019, fiscal 2020; and any particular product categories that you're looking to fill up on. Thank you.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Okay. I'll quickly take the seasonal trend question and then Vincent will take the cash question. Seasonal trends, our Q4 is always, obviously, a big step-down from Q3 and it will be this year completely normal and we expect it to be. All the categories tend to step down as you go from Q3 to Q4, except for Video Collaboration, which generally has produced steady progression all the way through the year.

A

Maybe it's hit a little bit by the – by the end of the year, close of the cycle budgets or something within companies. But generally, it's pretty consistent. Tablets have a little bit stronger skew in the Q – in the – well, a little bit stronger skew in the Q4 period because they're an education business. So – but anyway, the bottom line is I think, overall, without getting too specific, I'd say our seasonal trend should look this year in Q4 like they did last year; kind of relative to Q3, Q2 and Q1.

And Gaming, you mentioned specifically. You know, Gaming does have a very strong Q4 SKU, maybe even stronger by the fact that we're now in this – in all the key segments of Gaming. And so, putting those are really giftable, like steering wheel and things. So, I would expect that, you know that – that seasonal SKU will be pretty dramatic but it always has been.



Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

If I can add a few things on seasonal. Normally, sequentially going into Q4, our sales dropped 25% to 30% Q-on-Q. The guidance we've given for the year considering there's only one quarter to leave kind of implies about historical linearity going into Q4. So, nothing – nothing unusual on that side. I agree with Bracken. The Gaming trend structural growth there would continue.

And then, on Mobile Speaker, I would not expect a repeat of the Q3 deliverable and then we'll continue to grow the category trying to gain share. But obviously, we're not guiding a full year at 34% growth for that category. I'll give you a little bit more quantitative data as well.

And then, you asked about capital allocation, we have a framework. First, well, of course, we invest in our businesses as you've seen now is the seventh quarter of double-digit organic growth and we have plenty of opportunity continuing to invest on that side. We'll include into the gross investment, small and medium size acquisition, as we continue to see them. We're very pleased about the acquisition we've made and we continue to build up those businesses as they are integrated into the overall Logitech portfolio. And then, the last two leg of the tool if you want is growing a dividend or dividend that's growing on an annual basis. You'll continue to see that. Obviously, that's a board review and discussion we have every year and we'll have that as well. And then, we have a buyback program open for \$250 million dollars, out of which we've consumed \$20 million. So, we still have plenty of power there to continue to return cash to our shareholders.

Asiya Merchant

*Analyst, Citigroup Global Markets, Inc.*

Q

Great. Thank you.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Thank you.

**Operator:** Our next question comes from Ananda Baruah from Loop Capital. Please go ahead. Your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Okay.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Hey. Good morning, guys. Congratulations.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Hey. Good morning.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Can you guys hear me okay? Yeah. You're welcome.

Q

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

Yeah. Hi, Ananda.

A

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Hey, Vincent. Yeah. Just a few for me if I could. Like with regard to the very balanced and punchy demand, are you guys able to discern or distinct between the various drivers, market versus share. And then, in the share context, could you sort of peel back, kind of both you guys, what's willing to be shared if you could distinct between things like innovation, marketing campaigns, new channels, geos like that. And then, I have a follow-up or two. Thanks.

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Sure. Yeah. I'll step into that one. I'd say overall we're gaining share across most of our markets. And there are certainly cases where we're not, but they tend to be regional country base, et cetera. So, overall, our markets are growing. You know the general profile of the markets we're in and I would say the profile really hasn't changed very much if we step through the various pieces.

A

You know, the video collaboration market continues to be strong and we continue to do well within it from a share standpoint. Gaming is now multi-market and, I would say, we are gaining share in most of the segments of Gaming. The markets themselves continue to be very robust.

If you look at the music, the music business is very dynamic, as you know. And you know, this is the – the rise of the personal assistant is actually fueling a strong growth in speakers across both Wi-Fi, in-home, and to some extent, even out-of-home. So, the overall speaker market grew and we actually had a good quarter from a share standpoint there, too.

We'll have to wait and see at how speakers continue to evolve, but we're excited about the innovations available in loudspeakers, and we're going to really be after that aggressively. If you go into the home, I think the home is going to continue to grow across every segment. We had good growth in both of our businesses that are home-based businesses, the security camera business and the Harmony business which is now, I think, ready with personal assistance.

So, I would say, it is generally. And then, of course, there's the earphone business and earphones for us is a brand new business. It's the completely wireless version since at the early days. And we're really excited about that space, too.

So, opportunities across the PC peripherals, on the other hand. The PC business has been in a secular decline for a while, not steep but steady. We have been disturbed by that because we feel like we're really an installed-base business there. It started to turn a little bit. We've been a little bit positive the last quarter or two. And, I think, we continue to expect to either hold or gain share in that segment, too. This quarter is really, I think, more of an anomaly. We're actually down 4%. The trends underneath that look pretty stable from a sell-out standpoint.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Awesome. Awesome. And Vincent, with regard to, I guess, gross margin usage from the 150 basis points from the distribution center dynamic. When do you guys decide what you want to do with that or have you already decided? And just as we get our – you know, sort of get our heads around sort of the next couple of quarters, when do you think, like potentially, when do you decide or have you decided whether your path give some back to yourselves or given the [indiscernible] (26:00) performance, you just, you can put it back in the investment of the business?

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Yeah. I understand. And to be fair, the issue started in September. And deciding what to do...

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

[indiscernible] (26:12)

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Maybe people have noticed, too, so the question is around the gross margin impact of a one-time 150 basis point from the distribution center issue in the Americas. And the question is, what have we decided and by when will be out of it basically. And the decision was easy. Our decision, as we explained in the last call, was to run two DCs in order to not put at risk the demand we saw into Q3. And when I look back at the results and the demand that flooded are the all that came in, we made the right decision.

Then, the solution, if you won, is to go back to one DC. Internally, we've made all the choices and now is to be generated at the end of December and early January. We started to deploy that solution. We may still have a little bit of residual cost in January as a result of that, but we will be out of it now as we speak. And every impact of that DC of course has been built into our overall guidance we've raised for the year.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Okay. Got it. Got it. So, we shouldn't necessarily think of getting 150 basis points back over the next couple of quarters and that floating back into the gross margin percentage that you guys reported.

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Yes. Yes. 100%. Yes. You see, it may still take a few weeks in this quarter, will not take two quarters.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Right.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Okay. Thanks. And just quickly, last one for me, what – when you make comments about when your tax rate could be as a result of tax reform – your ongoing tax rate? And then just if sort of – what might you do with deployment of tax savings and the creation of this?

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Yeah. So, just quickly, the tax rate, I'll give on annual basis, of course, depends on the mix of sales by product line and region, since every country has different tax rates. At this point in time, we've lowered our annual tax rate on a non-GAAP basis to 7% for FY 2018, and then, we'll give more color at the [ph] AID (28:27) meeting in March.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Okay. Great. And then any use of repatriated cash?

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

We didn't have any repatriation cash. We are a Swiss company and our cash is in Switzerland.

Ananda Baruah

*Analyst, Loop Capital Markets LLC*

Q

Yeah. It makes all sense .Okay. Thanks, guys. Congrats.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

All right. Thank you. Thank you, Ananda.

**Operator:** Your next question comes from Jürgen Wagner MainFirst Bank. Please go ahead. Your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Hi, there.

Jürgen Wagner

*Analyst, MainFirst Bank AG*

Q

Hi. Good afternoon.

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Hey, man.

Jürgen Wagner

*Analyst, MainFirst Bank AG*

Q

Hi. Thank you for taking my question. Actually, I have two. First on PC peripheral that was down a bit. How should we model this business going forward? I think you mentioned like stabilize that – the trend we should look at or more also the mid-term. And then, on Europe, you have this chart on page 13 that shows that reported in constant

currency, Europe keeps underperforming to now flattish. Is that underperforms due to one country or is it across the board? Thank you.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Okay. I'll take both of those. So, in terms of the first one, PC peripherals, I'm not sure exactly how I would model them if I were you, but I'll tell you how I thought about – I always think about them. I would think of our PC peripherals business as relatively flat, could be slightly up. And I think that's underneath the sell-in numbers. I think that's pretty much what we saw in terms of really sell-through. I think – I suspect that will continue. I don't see any fundamental change in the market that suggests it can be different from that yet. And I don't see any – I can't imagine what they would be.

Now, in terms of Europe, as I mentioned earlier, we've had a, I think, one of the things that happens when you have a great year one year and a lighter year the next year, you often do have an adjustment that's got to take place and the adjustments takes place in steps. And I think you're seeing that in Europe, I've had this couple of times in my career where it's kind of staged in as the realization comes through and the sales really need to be pulled back. And that adjustment ends up being reflected quarter-over-quarter-over-quarter.

And so, you hit the end of that, you release; then, you finally sort of come back up again. And I think that's what's going to happen here, I think we're probably another quarter away from being to the point where you'll start to see the underlying sell-out look more like the sell-in and right now the sell-out is consistently stronger than the sell-in. And that's really an adjustment that's happening in different stages of the distribution channel as they adjust to the new sell-out. So, I think you'll see it start to come back up as we enter next year.

And in terms of individual countries, et cetera, it's fairly consistent across the board, but there are some differences across country as usual. We're seeing a stronger performance now coming back out of that. Some of the markets that are really weak a year or two ago actually two years ago, Russia for example, started to come back a little bit for us, which is good. Turkey is starting to come back a little bit, which is good. So, it's kind of – it's a bit – generally speaking, I think you can think of it as pretty broad based.

Jürgen Wagner

*Analyst, MainFirst Bank AG*

Q

Okay. Thank you.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Thank you.

**Operator:** Your next question comes from Paul Coster from JPMorgan. Please go ahead. Your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Hi, Paul.

Q

Hi. Hi. Hey, Bracken. Hi this is [ph] Paul Chung (31:37) on for Coster. Thanks for taking my question. So, great quarter, guys. So, it just looks like Gaming is on track to become your largest category possibly by mid-fiscal year 2019. So, how should we think about the growth trajectory in 2019 going up against a healthy comp in 2018? And if you can expand on the primary growth drivers there, market share grab, higher ASPs, higher shipments or just the combination of everything?

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Yeah. I would say, to answer that last one, I think it's kind of a combination of everything. I think we're – we're playing across a lot of different places in gaming now and it's continued to expand and I imagine it will continue to expand. And, I think, we have had a good run and we generally guided every [ph] AID kind of out, (3:23) two or three years in place, save it for that. But we expect to do well in Gaming going forward, to be clear.

Q

Okay. Then on, Vincent, on the margin front, my understanding is that the gaming product margins are slightly above the corporate average. So, as the product mix evolves, do you see a step-up in longer term gross margin targets? Thanks.

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

So, yeah. So, if I can come back on Gaming. Gaming is the perfect illustration of the three growth drivers we're talking about, right? There is a structural growth in the market and market going double-digit, and we see that to continue for the years to come. There is definitely an opportunity to continue to grab more market share in the current product lines we are in. And that's why we're focusing on through either new products, as you've seen all the new products we've launched and we'll continue to do that going into FY 2019 or execution at the point of sale.

And then, the third one is there's plenty of small acquisitions that can continue to complete the portfolio and become a true gaming, almost kind of company inside a company. And we're definitely doubling down on that growth opportunity.

In terms of the margin, yes, it's slightly better than the corporate average when you take multi leverages. I don't see a major uplift from that perspective. I would say we continue to manage the overall portfolio in the 35% to 37% range. Gaming trending better gross margin. We may also invest more into marketing in the overall support of growth. So, I think in all of our businesses, we're trying to continue to improve gross margin to then reinvest a portion of that into growth opportunities.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

By the way, [ph] Paul (34:08), just to make one other comment. Thank you for the quote because I'm going to feed that back to our – the other business groups and our team because I don't think they're going to sit there and wait for Gaming to become the number one no matter what the growth rate is. We've got plenty of other categories. They're super excited about the growth potential. And PC peripherals is by no means going to see that easily, and when you add Video Collaboration and even the Music business. So, I think there's opportunity to a lot of places to be bigger.

Q

And then, my last question. So, how should we think about the split between smart speakers versus the Bluetooth speakers in the quarter and how that evolves over time? And what were the kinds of primary growth drivers in this quarter? Was it a function of ASP, higher sell-through, combination of both, maybe some channel strategy? And then, was there some pent-up demand from 2Q? Thank you.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Yeah. I don't think there's any pent-up demand from Q2. But I'd say the, in terms of the split, it's still the vast majority of Bluetooth speakers. We just launched our first Wi-Fi personal system-enabled speakers and it's way too early for us to really forecast where that's going to go. It's safe to say there's a whole new dimension of opportunity for us to build into this market. So, we're excited to see where that can go.

In terms of what really growth, growth in demand this quarter, it is both growth in units. We had very strong growth in our WONDERBOOM, a new addition to the category. And we still had strong growth in MEGABOOM. So, it was really kind of strong across the board. And yeah, I would say it was a kind of a really balanced performance. We gained some market share. We had good ASPs and we had good growth overall.

Q

Thank you very much.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Thank you.

**Operator:** Your next question comes from Andreas Mueller from [ph] SKB (35:55). Please go ahead. Your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Hi, Andreas.

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Hi, Andreas.

Andreas Mueller

*Analyst, Zürcher Kantonalbank*

Q

Yes. Hello. Thanks for taking my question.

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Sure.

Andreas Mueller

*Analyst, Zürcher Kantonalbank*

Q

One is on that G&A line, which dropped significantly. Can you give an indication what were the drivers behind it had done and if it's going to be sustainable on an absolute level, the G&A line?

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

A

Yeah. So, on the G&A line non-GAAP with around \$18 million, past quarter with around \$21 million. There's a few things in and out where some of the variable expenses in G&A. As Bracken mentioned, he's holding the team accountable for some of the gross margin metrics and we have not hit all of our metrics. So, some of the adjustment you see on a quarterly basis is adjustment to variable compensation for the executive team. On an ongoing basis, as you know, we have our G&A position at around 3% of sales. I hope we can do better. And I think that's what you will see as trending in that direction on an annual basis.

Andreas Mueller

*Analyst, Zürcher Kantonalbank*

Q

Okay. Thanks. And then, probably back to you UE BLAST, the MEGABLAST, can you indicate a bit what was the sell-through relative to selling? And also for the new Jaybird products, RUN and Freedom 2, what is the big difference between selling and sell-out or should we think it's basically the same metrics there?

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

A

Yeah. Generally, when we ship a new product, we have higher sell-in and sell-through and that's true on both those products. They both ship – the sell – especially with BLAST and MEGABLAST shipped midway through the quarter. So, you'd have significantly higher sell-in and sell-through. So, it's still very early days in that category.

I think its early days for the category of personal assistants that are not Amazon and Google. And so, we're going to have to wait and see how that really develops over time and determine how we feel about the category in general and whether we've got the right price performance profile, et cetera, and we're watching it closely.

On the Jaybird practice, it's a little bit of a different story. We've shipped a little earlier, we're a little constrained on demand, so I think the sell-in and sell-out profile probably looks a little more balanced at this point in the quarter that's because it shipped earlier. If you step back from that overall, our channel inventory picture looks quite good and we feel good about where we are.

Andreas Mueller

*Analyst, Zürcher Kantonalbank*

Q

Good. 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. Please go ahead, your line is open.



Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Hi, Mike.

A

Michael Foeth

*Analyst, Bank Vontobel AG (Research Firm)*

Yes. Hi. Hi, Bracken. Hi, Vincent. A question on Jaybird as well. Can you maybe update us on the – on sort of the repositioning of the product in eventually new channels as well and give us an idea of the geographic mix that was responsible for the strong growth. And then, in terms of the rollout of the BLAST speaker series, can you [ph] dare (38:59) give also some granularity with respect to which regions it was strongest in demand? Thank you.

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Sure. I mean I can answer that really quickly, the U.S. Really, if you look at where we're – that is an Alexa enabled speaker. So, really Amazon and Alexa have led with the U.S. and then it's slowly spreading into different countries in Europe and it'll spread elsewhere. So, still early days, virtually everywhere outside the U.S.

A

In terms of the repositioning of Jaybird, we're really, as you know, we are really narrowing that position and we are shifting the distribution a little bit. Well, we haven't seen much of that yet. That will come a little bit more over time. But, I'd say, we're on track. I'm super excited about the category and the brand. I think we've got something unique here and we've also been a – continuing to build out that team and I'm really excited about that, too. I hope they're listening.

So, you want to add anything to that, Vincent?

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

No. I don't.

A

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Okay.

A

Michael Foeth

*Analyst, Bank Vontobel AG (Research Firm)*

Maybe on Jaybird as well. Do you have any collaboration or cooperation with any sort of sports brand that you have already or looking into.

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

We do actually. Yeah. We have several. I'm not kind of comfortable talking about it. I'm not sure exactly what we have and haven't disclosed. But I'm not comfortable giving too much detail there. But we do have collaborations with other sports brands and with sport athletes. And so, we've got some really cool things that are underway there.

A

And we're really dedicated to building a sports brand there. And we bought one that was already kind of born innate in the outdoors and we're committed to building it. And it will certainly include collaborations with other sports players.

Michael Foeth

*Analyst, Bank Vontobel AG (Research Firm)*

Okay. Thank you.

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Thank you.

A

**Operator:** Your next question comes from Guenther Hollfelder from Baader Helvea. Please go ahead. Your line is open.

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Hi, Guenther.

A

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

Hey, Guenther.

A

Guenther Hollfelder

*Analyst, Baader Helvea*

Yeah. Hi. Thanks. Just two follow-up questions, one again on the European performance, does it make any sense to differentiate by product categories? Are there any major differences you want to mention here?

Q

Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

No. I would say the PC peripherals business was weaker in Europe than elsewhere. Again, I think, it was kind of balanced out by other two categories. So, there's nothing particularly worrisome about that. I think that's pretty much a natural trend. But other than that, I would say by category, there's not a big difference.

A

Guenther Hollfelder

*Analyst, Baader Helvea*

Okay. Thanks. And a follow-up on the currency tailwinds. The 80 basis points you were – were you referring to the gross margin here or non-GAAP operating margin?

Q

Vincent Pilette

*Chief Financial Officer, Logitech International SA*

Yeah. No, gross margin.

A

Guenther Hollfelder

*Analyst, Baader Helvea*

Q

Gross margin.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Although, which, as I mentioned, more than half a point was hedging cost. So, 80 basis point was a gross number and then you offset that with hedging cost, which is a one-time cost, and if the currency is still weighted, then we would benefit from that 80 basis point.

Guenther Hollfelder

Analyst, Baader Helvea

Q

Okay. Last question on the share buyback. I mean, you're running right now, I think like slightly above \$20 million, compared to more than \$60 million after nine months last year. Is the main impact from the acquisition or could you talk about the volumes right now and what you'll be able to catch up in the fourth quarter?

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Yeah. So, at the end of last fiscal year, we closed the old plant and opened the new one, right? The new \$250 million, we couldn't do anything in the first quarter because of the acquisition, as you mentioned. So, we're prevented from that. And we now have established kind of a pattern and we'll continue opportunistically. And also, a small portion of the plant will be to [indiscernible] (43:03).

Guenther Hollfelder

Analyst, Baader Helvea

Q

Okay. Thank you.

Bracken P. Darrell

President, Chief Executive Officer & Director, Logitech International SA

A

Thank you.

**Operator:** [Operator Instructions] Our next question comes from Joern Iffert from UBS. Please go ahead. Your line is open.

Joern Iffert

Analyst, UBS

Q

Yeah. Hi and thanks again for taking my follow-up question.

Vincent Pilette

Chief Financial Officer, Logitech International SA

A

Hi, Joern.

Joern Iffert

Analyst, UBS

Q

And maybe a little bit unfair question because you launched so many products with good reviews, but looking at a couple of launches and strongly growing end markets like the MEGABLAST, the Jaybird RUN, or the Circle 2, the consumer reviews seems to be below Logitech's normal average. Can you maybe comment how you – what are

you doing, I mean, to improve the consumer experience here? Is there already something maybe that you have done and we can expect a couple of upgrades and re-launches going forward? Just some more color would be appreciated here. Thanks.

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**Bracken P. Darrell**

*President, Chief Executive Officer & Director, Logitech International SA*

A

Yeah. I think it's a great point and we do have the three individual – the specific three image – the three of the – if somebody would ask me about it, I would brought it up, all three of them have pretty – pretty difficult technical challenges to them in their relatively new markets and – or at least we're trying to do something that's pretty really challenging.

If I go through each one and each one of them we've got aggressive upgrades that have already happened or happening. And so, I think you'll see those reviews come up. Jaybird RUN is a – was a tough product. We launched it. We actually needed one more firmware update after we launched the product. We – it's a phenomenal product. Now, with the first launch. If you go and look at the reviews, you'll see some antenna issues where it was disconnecting. We made the change completely good, but those early reviews that came though without that update, we suffered for them. I think we learned from that.

Same thing was true with – Circle camera is exactly the same story. We have – we launched with – it was – the wired version is amazing. It gets already to top everything. The wireless version when we launched it had some difficulties in the beginning. We've largely I think fixed almost all, if not all of those. And so, that product is also awesome, but in the beginning it was tough.

And the third was BLAST and MEGABLAST. Where BLAST and MEGABLAST, we were really the first out of the gate with the premium Wi-Fi speaker that had Alexa enablement, and we were really penalized by the fact that there were some features that we just couldn't put in there, that we expected to be able to, and we had to sort of wait. And so, those were coming, or they've come. You'll see them over the next Spotify for example, it was a big one. PANDORA, we just launched.

So, all three of those are I think good examples of our learning curve, and we're learning how to be more than just a hardware company. And I think in every case, the product will come up to the standard that we're known for. I think in two or three, if not three of the three, we're already there. But it's a good experience for us. It's a good jump in the cold water to realize that our own internal development cycle might need a little extra time to make sure that we finish off the end of the software development cycle, and prove to ourselves that we've got what we thought we did. Now, obviously, we've been doing this for a long time, so, we're pretty good at it. As you mentioned, our Amazon ratings, our Best Buy ratings, our ratings in general are quite good in our products. And I don't like having, launching products that don't immediately hit those really good performance levels, and so, you can imagine that we've had a lot of discussions internally about that. But it's good because we're going to do more and more of these kinds of products and we need to be able to always come out of the gate strong.

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**Joern Iffert**

*Analyst, UBS*

Q

All right. Thanks for the comments.

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**Bracken P. Darrell**

*President, Chief Executive Officer & Director, Logitech International SA*

A

Thank you.

**Operator:** And there are no further questions at this time. I'll now turn the call back to Mr. Darrell for closing remarks.

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## Bracken P. Darrell

*President, Chief Executive Officer & Director, Logitech International SA*

Okay. I think my last line of our Q2 call was that we're entering Q3 with the strongest lineup we've ever had leading into a holiday quarter. And I think I also said we just won more awards – more design awards, which really represent design, innovation and engineering than we've ever won before as a company, and maybe more than any other company in revenue-for-dollar basis, except the really small company. And I think you saw in the numbers that we just reported that we just had our highest sales ever. So, this is all connected. We just have a lot of momentum.

Now, the best thing about this story, and the thing that maybe in a weird kind of perverse way, I'm most excited about, is how much better we could have done. I think we underperformed that we are capable of this quarter, despite having the highest sales quarter ever, despite having profit levels grow in line with sales. And the best thing about that is that virtually everything that we could've done better, or most of those things, were one-time things we can fix. So, I'm super excited about the future. I think we're on a really good track.

I also want to let you know that we are going to be holding, as usual, an Analyst and Investor Day in Zurich this year. It's going to be Tuesday, March 6. You heard it here first. Put in your reservations early, and we look forward to seeing you there.

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## Vincent Pilette

*Chief Financial Officer, Logitech International SA*

Thank you.

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

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