

Company Name: Logitech
Company Ticker: LOGN SW
Date: 2018-07-31
Event Description: Q1 2019 Earnings Call

Market Cap: 7,550.91
Current PX: 43.62
YTD Change(\$): +10.72
YTD Change(%): +32.584

Bloomberg Estimates - EPS
Current Quarter: 0.396
Current Year: 1.727
Bloomberg Estimates - Sales
Current Quarter: 679.250
Current Year: 2809.636

Q1 2019 Earnings Call

Company Participants

- Benjamin Lu
- Bracken P. Darrell
- Vincent Pilette

Other Participants

- Asiya Merchant
- Joern Iffert
- Scott McConnell
- Jürgen Wagner
- Michael Foeth
- Paul J. Chung
- Günther Hollfelder
- Ananda Baruah

MANAGEMENT DISCUSSION SECTION

Operator

Good day, and welcome to the Logitech's First Quarter Fiscal 2019 Financial Results Conference Call. At this time, all participants are in listen-only mode. We will 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 now introduce your host for today's call, Mr. Ben Lu, Vice President of Investor Relations

Benjamin Lu

Thank you, Kim, and welcome to the Logitech conference call to discuss the company's financial results for the first quarter of fiscal year 2019. 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. 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

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GAAP and non-GAAP numbers and are posted on our Investor Relations website. We encourage listeners to review these items.

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

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

I'll now turn the call over to Bracken.

Bracken P. Darrell

Thanks, Ben, and thanks all of you for joining us, especially those in Switzerland who've decided to join us in spite of the fact that you got a big holiday tomorrow. When I started in 2012, there were a lot of people who told me you need to go private to do what you need to do, but didn't think we need to do that in order to change ourselves. I'm mentioning that because I love being a public company.

Public companies are sometimes criticized for being only short-term or quarterly focused. For us, the rhythm of closing and reporting every three months creates something different. It drives a heartbeat inside Logitech that keeps us sharp and nimble but never impacts our focus on long-term value creation. That's the key to everything we're doing.

As a public company, the first quarter is a key quarter. A good year usually starts with a good first quarter, and this was a very good first quarter. Our sales increased 12%, while our operating profits grew 41%. I want to focus you on our – and I'll use the terms I did or we did at the Analyst and Investor Day, our newest, our coolest and our oldest businesses for just a minute. As you know, we're doubling down on two key businesses: Video Collaboration, our newest major business, and Gaming, our coolest major business. And this doubling down is paying off. Both businesses grew over 60% this quarter.

Video Collaboration continue to benefit from both our increased resources in sales and our increased resources in engineering. Gaming was our biggest business this quarter, bigger than mainstream Pointing Devices and bigger than Keyboards & Combos. What about our oldest business? Well, we will not stop innovating in our oldest businesses. Pointing Devices and Keyboards continue to grow because of that innovation engine. And webcams and tablet accessories grew double digits this past quarter.

The bottom line is that while we build a multi-category multi-brand company, it's diversified. While many public companies start with a single category, they have to be really lucky particularly in hardware. There are just too many variables to predict how their growth prospects will fare over the next few years, much less the next decade. That's why we love to be a multi-category company. We can ramp up or ramp down investments against various businesses as we see opportunities, reset them when they slim down. That's what we did this last quarter. Like many other periods before it. We're evolving to exploit the opportunities ahead of us and there are many.

Now, let me go through our strong quarter results – our strong results [indiscernible] (00:04:40) quarter. Gaming is off to a great start for the year with sales up 68%. That was the fastest growth rate we've seen over three years, and we were much, much smaller then. Gaming growth was broad-based across all three regions and all our major product lines, gaming mice, headsets, keyboards and steering wheels. ASTRO was also a stronger contributor to our results and actually tripled in size versus the prior year.

I was just in New York this past weekend and saw the inaugural Overwatch Finals. One of our sponsored teams, the London Spitfire, won the championship, congrats to Jack and his players. The level of energy from the 22,000 fans in the sold-out Barclays Center was simply incredible. It was like being at the NBA finals I went to a few years ago when the Cavaliers beat the Warriors. And I'm sorry to use that example for you Warriors fans.

The outlook for the gaming market has never been brighter with eSports becoming one of the most viewed forms of entertainment, and very likely a future part of the Olympics. In fact, we participated in a meeting on this at the home of

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the International Olympic Committee two weeks ago. And you can't talk to anyone under 25 without hearing about a new blockbuster game Fortnite. This new game phenomenon is driving even bigger engagement with both new and existing gamers. We believe this trend of new engaging games will happen again and again over the years ahead, while the major eSports games of today will continue to grow. But this engagement is not about a single game like Overwatch or fad. Gaming is a rare long-term secular and generational change.

With an amazing World Cup having just ended, imagine for a minute, if the game of soccer had just been invented 20 years ago. Can you imagine the growth curve ahead of it? Or if you're an American, this creative eSports is like the 1960s in American football and the NFL or the 1960s or 1970s in basketball like the NBA, as these two pro sports franchises started to climb and interest continue to grow. Most engaged in those early days were the kids who played the games, like me, the youth. That's what you're seeing today in eSports. Gaming started with the young and has been growing for years. eSports is emerging out of that. Instead of the Premier League, the NFL or the NBA, these leagues are League of Legends, Overwatch and others. One day eSports collectively will most likely be bigger than all of them. As we told you before, our goal is to be the Nike or adidas of eSports.

As I mentioned earlier, Video Collaboration sales also grew 60% in Q1. Our newest Rally Camera just began to be available. It's a modular system that not only delivers premium audio and 4K video, but also features our latest software, intelligent software which we call Logitech RightSense. RightSense leverages our computer vision know-how to automatically [indiscernible] (00:07:36) the camera around the person or people in the room.

It also automatically optimizes the lighting, the sound and the audio based on the environment you're in, adapting to dark or noisy environments for example. With these automation and computer vision's features, you can see we're investing to expand our software capabilities, and all this for a mere fraction of what it historically cost to video-enable a room. The world is quickly moving to video and we aim to be at the forefront of this adoption. PC peripherals grew 5%, driven by growth in Pointing Devices, Keyboards, and Webcams. You know we love this business and we'll continue to introduce new products and experiences regularly.

Tablet & Other Accessories grew 37%, and this comes on the heels of 38% growth last year and on top of a very tough compare in Q1 of the prior year at 71%. The iPad tablet market itself is up 7% in the last 12 months, and we're growing, thanks to new product innovation, share gains, and channel expansion.

Moving to Mobile Speakers, sales fell 46% in Q1. As we mentioned in our last earnings call, the market for third-party voice-enabled speakers as well as the overall Bluetooth mobile speaker market have slowed over the past several months, and we're rightsizing our channel inventory and resetting our pricing. While we continue to introduce new products with improved experiences, we're adjusting our investments to match the slower market growth outlook. Should the market growth accelerate, we'll be ready, believe me, to capture the upside.

Audio & Wearables sales were up 2% versus same quarter last year. Headsets grew in the quarter, offsetting a slight decline in desktop speakers. We continue to position Jabber for our niche applications in the wireless earbud market. Our Smart Home sales in Q1 declined 46% against a strong Q1 last year where sales grew up roughly 50%, and we saw a change in the overall growth profile of this dynamic category.

With that, let me turn the call over to Vincent to walk you through our financial metrics.

Vincent Pilette

Thanks, Bracken. As you mentioned, we had a very strong start to the year. Sales grew 12% in constant currency, 15% in U.S. dollars. ASTRO contributed 5 points to our company's growth and showed strong growth year-over-year. Building value into acquired assets is a capability that we are steadily and quietly developing. Non-GAAP operating income increased 41% to a better-than-expected \$61 million and non-GAAP EPS reached \$0.34 compared to \$0.24 a year ago.

In Q1, our gross margin reached 37.4%, which included a one-time benefit of approximately 60 basis points from a legal settlement with our prior supplier for our distribution center in the Americas. We remained comfortable with

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managing our business within our gross margin target range of 35% to 37% as we balance various factors like logistics and supply chain cost pressure, currency exchange, volatility or even tariff uncertainties with our overall efforts on maintaining ASP trends, taking cost out and freeing up gross profit dollars to reinvest throughout our organization.

I know many of you are wondering about the impact of the new China-to-U.S. tariffs on our business. Let me share with you what we know so far. The first [ph] one-off (00:10:59) tariff has had a relatively immaterial impact on our products sold in the U.S. It's too early to assess the effect from the second proposed [ph] run-off (00:11:08) tariff. In the event these new proposed tariffs are implemented, we are currently investigating various mitigating actions such as pricing, trade classification of products or making adjustments to our overall supply chain including manufacturing.

Now, let me come back to our Q1 P&L. Our non-GAAP operating expenses increased 9% or 6% excluding our acquisition compared with U.S. dollar sales growth of 15%. R&D spending increased 12%, sales and marketing expense rose 11% both to support the strong topline growth in the year. And at the same time, we continue to manage tightly our G&A spending which was down 3%. You can expect us to continue to optimize our spending, while we build out our capabilities and introduce new products and experiences.

Last quarter, we had mentioned that we're continuously transforming and reallocating resources to shape the portfolio for the future. This quarter we booked a one-time \$10 million restructuring charge for evolving our capabilities for growth opportunity. To give you a few examples, we are standardizing sales processes across regions. We are placing more resources to enhance our software capabilities, and we are accelerating changes in our cost structure in slower growth categories, so we can double down faster into higher growth markets. We're still in the process of reviewing some smaller residual areas to optimize in FY 2019.

In the quarter, we also adopted the new 606 revenue accounting standard. This had a nonmaterial impact on our P&L but it led to some reclassification on our balance sheet between accounts receivable and other liabilities. It does not have any operational cash impact, but it does affect the calculation of our DSO and our net receivable balance as reported. You can refer to our 10-Q when it is filed for more details on that topic.

Cash from operations for the quarter amounted to \$12 million versus roughly breakeven a year ago leading to a total cash balance of \$604 million at the end of June. Working capital metrics and related balance sheet items, inventory AR, AP were all in line to historical trends for June quarter excluding the noncash impact of ASC 606.

In summary, we delivered a great start to the year with our Q1 results, but there is still so much more that we can do. We're not only excited about the opportunities for the rest of the fiscal year but for the next few years as well.

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

Bracken P. Darrell

Thanks, Vincent. It is great start to the year, but as Vincent said, there's so much more to come. We shared our vision many times about a multi-brand, multi-category companies, a vision we are methodically marching towards. We'll focus on secular growing markets, innovating with design and engineering into our existing categories at the same time. And at the same time, we're also always on the lookout for and innovating to meet exciting consumer technology trends whether that's internally, organically, or through tuck-in acquisitions. In fact, we just announced today that we've agreed, and I'm excited to announce it here, to acquire Blue Microphones, a top player in the microphone space.

Microphones are used by gamers as they stream and podcast just as they podcast and performers on stage. It's a category we've been interested in for a while, we're very familiar with because of our webcam business, and we couldn't be more excited about the terrific team, brand and business that we've brought into the Logitech franchise.

Given our strong Q1, we're raising our outlook for fiscal year 2019 for both net sales and operating income. We're increasing our net sales growth to 9% to 11% from high single digits, and non-GAAP operating income to \$325 million to \$335 million from \$310 million to \$320 million.

And with that, Vincent and I are very ready to take your questions. Operator, please queue them up.

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Q&A

Operator

[Operator Instructions] Your first question comes from Asiya Merchant from Citigroup. Your line is open.

<A - Bracken P. Darrell>: Hello there.

<A - Vincent Pilette>: Hi, Asiya.

<Q - Asiya Merchant>: Hi, Bracken. Hi, Vincent. Hi, Ben. Congratulations on a great quarter.

<A - Bracken P. Darrell>: Thank you.

<Q - Asiya Merchant>: I guess I was going to ask about the acquisition, if you can provide some more guidance. I mean, it's one of your larger acquisitions that you've done. You guys are building the capability to integrate these acquisitions rather well, given your prior experience with Jaybird and ASTRO. But just in terms of this category, while ASTRO was pretty well-known, the impact to gaming, et cetera, maybe you can help us understand like how you think about this category from a growth perspective; also maybe about the margins, how does that compare to your other product portfolio and how we should think about the growth going forward into fiscal 2020 as you guys integrate Blue.

<A - Bracken P. Darrell>: Yeah. Vince and I can [indiscernible] (00:16:31). First of all, we've been looking – mentioned it in the opening – we've been looking at this business for a while. In fact, we've been quietly working on products in this space. I have mentioned several times, I can't imagine us doing an acquisition, where we weren't already working internally on the category in small teams trying to develop products that were competitive in the space.

But we're always looking on the outside in these so-called seeds to see if there's something we could bring in that could either accelerate or differentiate what we're up to. And this is a poster child for that, just a spectacular example of where we can bring in really if – I mean, it's really difficult to say who the exact leader in the space is because it can be defined different ways, but really I would say the leader in the space, the conceptual leader and a product leader in that space into our franchise.

They look a lot like the UE business when we first bought it many years ago, Ultimate Ears. They're both in the professional space, but then they expanded into consumer. They have done a great job with both design and engineering and product development. The team itself has been stable and they're strong and we really like them. And we think culturally, they fit extremely well. They're even located in the same city as the original UE custom business.

So, it's super exciting and I'm not disclosing any surprising market insight here. If you've got kids or if you're [indiscernible] (00:17:56) and you got a little hustle on the side yourself, you may well be podcasting or somebody in your house is. And if you're not podcasting, it might be somebody probably streaming, somebody you know is streaming themselves, playing games on either YouTube or Twitch, and that's right at the heart of what this business is about.

And we're very familiar with it because our Webcams [indiscernible] (00:18:14) exact same way and we've been developing that business for a while. You saw it grew 13% this quarter. And what many people would say, why in the world are Webcams growing. Well, that's why. Now, the other thing you need is a great mic. And so, we're super excited about it. I think the long-term prospects are good and the margins are also very good. I'll let Vincent respond to that further.

<A - Vincent Pilette>: Yeah. I can do two things. One is talk a little bit about the team, very rounded team for the business we've acquired. I think that's the most mature business team we've had. And from an integration perspective, we'll do what we've learned how to do, which is integrating the back end, helping them from manufacturing to channel expansion and really helping them to really focus on what matters, which is developing the brand and developing the product portfolio. So, that's our approach. The deal expect to close at the end of the summer. Bracken mentioned it's a

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growing business, it's a profitable business and the margin is in line to the margins we have across our portfolio on average, you know where they stand.

<Q - **Asiya Merchant**>: Great. Thank you. And if I can just have a follow-up on the organic growth. A lot of investors...

<A - **Bracken P. Darrell**>: Sure.

<Q - **Asiya Merchant**>: ...tend to focus on organic ex-ASTRO. Maybe you can clarify – I mean, you guys have done a lot with the ASTRO once you purchased [indiscernible] (00:19:28) you guys have expanded it to more of the mid-pricing tier. And so, how should we – what is the read with organic growth kind of perhaps slightly decelerating from where it was in the fourth quarter of last – basically the March quarter. How should we read into that? And then, as you lap the ASTRO acquisition in this quarter, how should we think about gaming growth going forward?

<A - **Vincent Pilette**>: Yeah. So, maybe I'll take that one. So, in term of organic growth, the way you would report it, if you take all of us, the reported number is 7%. I do want to point out that we have more than tripled the size of ASTRO since we've acquired, and that's called an organic growth. Right? So, if you just take the ASTRO last year as the baseline and then grow everything else, we're in double-digit organic growth. From a quarter-over-quarter perspective, that organic growth is actually improving.

And I think the real dynamic in our non-ASTRO portfolio is to isolate mobile speaker. And what we're doing with mobile speaker, rightsizing it for the market opportunities and also ahead of maybe other things that will happen there. The organic growth excluding mobile speaker is actually extremely strong and you've seen it in Gaming, in Video Collaboration and even in our PC peripherals where we've had a very, very solid growth.

<A - **Bracken P. Darrell**>: Yeah. And I'll add, the organic growth in our existing Gaming business excluding ASTRO is very strong.

<A - **Vincent Pilette**>: Extremely strong. So, from that perspective, we feel pretty good. In term of guidance overall, so we've raised the guidance as you know. We're not going to re-break it by category when we guide. But if you compare to the numbers we've said by markets at [indiscernible] (00:21:24) I would say at this point in time, the PC peripheral, what we call creativity and productivity, the Gaming and the Video Collaboration will do better, and then the music categories and the home category will do under the overall guidance. But it's a portfolio play and we still have three quarters to go before we can talk about the annual number.

<Q - **Asiya Merchant**>: Great. Thank you very much.

<A - **Bracken P. Darrell**>: Thank you.

Operator

Your next question comes from Joern Iffert from UBS. Your line is open.

<A - **Bracken P. Darrell**>: Hi, Joern.

<A - **Vincent Pilette**>: Hi, Joern.

<A - **Bracken P. Darrell**>: How are you?

<Q - **Joern Iffert**>: Hi. Thanks for taking my questions.

<A - **Bracken P. Darrell**>: Thanks for having one.

<Q - **Joern Iffert**>: The first would be please on the wireless speaker segment. Can you please clarify what was sell-through? And then, I recognize that the wording has maybe changed a little bit. I remember there was some inventory clearance ahead of new product launches. Now, it seems that investments are slowing down because the end market is deteriorating though. Can you help us what are your plans for your new product launches into the second half

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and also what is your expected growth rate for wireless speakers?

Next question will be, please, on EMEA. Adjusting for currencies, if I'm not totally wrong, like-for-like sales was around 3%. Do you expect an uptick here already in the next couple of quarters? And if yes, so why?

And then, the last question would be on new growth areas. I know it's a quite broad question, but is there something where you are confident that in one or two years you have third or fourth growth pillar on your portfolio in addition to Gaming and Video collaboration? Thanks very much.

<A - Bracken P. Darrell>: Well, you covered a lot, Joern, and very quickly. We'll see if we can remember the questions. So, first of all, let me go to your wireless speaker question, which was what's going on there. Okay. As we mentioned before, there are a couple of things going on there. One is the, as we said, we're resetting the channel for a change and really the growth expectations for that category. And so, we took a lot of channel inventory last quarter, some more this quarter.

And then, you mentioned that we mentioned and I think Vincent did in the last call that we always have new product development in the pipeline, and we do. We haven't disclosed anything. We're not announcing anything today. We don't have a timing that we're going to give you, but we always do and you can be sure that we do.

The second one, let me jump down to your Europe question. Yeah, Europe, we're – we don't like flat sales in Europe any more than you do. On a dollar basis, it's actually up 7%. But we feel really good about we're doing over there. We've structurally changed a few things inside the company, which was part of a longer term plan and I'm super excited about the team is doing that, and the process we're undergoing to do that and I think we're going to be in a really good place on the other side of what we're up to. So, I'm excited about that.

<A - Vincent Pilette>: And on that one, if I can add, I would say it's a first half versus second half story, Joern, and will improve as we progress toward the year.

<A - Bracken P. Darrell>: But you had two more questions, [indiscernible] (00:24:21) read my own writing here.

<A - Vincent Pilette>: I think you addressed the first two, right...

<A - Bracken P. Darrell>: Yeah.

<A - Vincent Pilette>: ...which is on mobile speaker, it's both, its channel, and its cost structure, as we align to a lower gross market. On EMEA, we've talked about it. And then the next one is really about the new growth drivers and area.

<A - Bracken P. Darrell>: Yeah. And Joern, you now know us. Okay. So, you know that whatever we're talking about today is by no means everything we're working on. That's not the model that we have here. So, we're always working on new category development, new ideas, new areas that we can drive for further growth and we intend – the mission of this company is to serially expand into new categories over time.

Now, rarely are we going to do multiple categories a year, and I wouldn't even guarantee that we'll do one a year. But I can promise you that we're always looking at new spaces that we can grow in, while we aggressively use design and engineering to innovate and build the businesses we're in to try to get to leadership or either a top one or top two. So, it's a diversified portfolio play. It will be more diversified over time, and that will – that's our strategy and we're super excited about where we've gotten too much. But much – you're always good as what we're going to do next and that's why you're asking the questions. So, we're focused on that too.

<Q - Joern Iffert>: All right. Thanks. If I may come back to wireless speaker, can you share with us the sell-through growth rate for Q1 and also what you expect for the full year for sell-in?

<A - Vincent Pilette>: Yeah. So, overall like in Q1, Joern, sell-through continue to be somewhat flattish, I would say, so much better than the sell-in number you see, and so, it's part of the discussion we've had. A part of it is channel management and another one is overall investment in cost structure. In term of the overall growth for the year, I would say you should expect a continued decline in Q2 and then improving in the second half.

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<Q - Joern Iffert>: Thanks very much.

<A - Bracken P. Darrell>: All right.

Operator

Your next question comes from Scott McConnell, D.A. Davidson. Your line is open.

<A - Bracken P. Darrell>: Hello there.

<Q - Scott McConnell>: Hi. Good morning.

<A - Vincent Pilette>: Welcome to the team.

<A - Bracken P. Darrell>: Yeah. Welcome.

<Q - Scott McConnell>: Yeah. Thank you. Thanks for taking my question. So, you touched on this a bit, but regarding the Battle Royale gaming format and the emergence of eSports, what gives...

<A - Bracken P. Darrell>: Yeah.

<Q - Scott McConnell>: ...you confidence that those are sustainable trends and not fads?

And second, how have you seen Fortnite in particular as increasing the total addressable market for gaming accessories including headsets by expanding the demographic for game players including to maybe younger kids and girls?

<A - Bracken P. Darrell>: Yeah. Well, it's hard to predict any single game whether it's a fad. It's going to go up and then eventually go down. But what I think the most important thing here is the secular trend that's been happening now for, I would say – really it's been happening for 10-plus years. It's really taken off the last five years. And we thought – actually, when Vincent and I started here a few years ago, we thought there would be more games like this that would come and explode, and then probably flatten or decline and then something else would replace it.

But I didn't see any of that for the – and to be honest, as excited as I was about gaming in general, I was a little disappointed because I thought that would spike interest in the Gaming business and the gaming category and bring more people into the franchise in an accelerating rate. That's exactly what Fortnite has done. So, it finally happened. I would say, it would be shocking if it didn't happen again. But I'm sure it will happen.

Fortnite is a really compelling game as you know. I had dinner in New York last week and when I went to the Overwatch Finals with a friend of mine and his 10-year-old son who really got into gaming because of Fortnite. And we talked for a while about all his friends coming into gaming, and he was having a debate with his dad about why he couldn't have a PC. So, he's using our headsets but not our PC.

So, I think that the Battle Royale format is very compelling especially since it's not – you're really working with other people at the same time, that you're playing a Hunger Games kind of event. And I think there will be – there are others and there will be more. But beyond that, the secular growth of gaming should just continue for a very long time as I said in the opening.

<Q - Scott McConnell>: Great. Thanks.

<A - Bracken P. Darrell>: Thank you. Next question.

Operator

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

<A - Bracken P. Darrell>: Hi, Jürgen.

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<A - Vincent Pilette>: Hi, Jürgen.

<Q - Jürgen Wagner>: Yeah. Hi. Good afternoon. Thank you for taking my question. Actually, I have two on your gross margin. You mentioned 60 basis points one-off positive. And you also mentioned the benefit of FX and cost cutting. How much [indiscernible] (00:29:08). And PC peripherals was, yeah, quite stronger than you expected. You said that. Were there any special events or promotions that drove that growth?

<A - Bracken P. Darrell>: Let me jump in and answer that one first. I'll let Vincent take the analysis of the gross margin. No, not really. I mean that was pretty much a normal quarter – a normal Q1 for us in PC peripherals. Now, in Q1, one of the fun things is Q1 has several big events in China that some of you may not be aware of, Brand Day. In Q2, Q3, you see Single's Day [indiscernible] (00:29:46), but that's not in Q1. So, you got a couple of big events that the Chinese market has which is good, but they're not big enough to really fundamentally change the number very much. Bottom line is that we did have Q1. We're excited about how we started the year in PC peripherals and stay tuned.

<A - Vincent Pilette>: Yeah. I can talk about the gross margin. We've normally done exactly [indiscernible] (00:30:04) impact. But this quarter, the main currency impacting was the euro versus U.S. dollars exchange rate was \$1.17 this quarter versus \$1.10 a year ago, so a 7% favorable delta. In the past, we've shared that when we had a [ph] 1 point time (00:30:23) two, three years ago, a 20% decline, we saw about a 3 points impact. So, around 7% would be around 1 point. There are other FX, of course, around other currencies, so it's not a perfect time, but gives you some idea to model. As we go into the next quarter, last year, the euro was \$1.17 actually and we currently have a spot rate at \$1.16. So, that FX impact going to Q2 should be much more moderate.

<Q - Jürgen Wagner>: Okay. And the cost initiatives [indiscernible] (00:30:56)?

<A - Vincent Pilette>: Yeah. So we continue to, as you know, working on our overall cost structure. It's an ongoing process, right, as we design new products to introduce them at better marginal – at the margin of the prior product and designing with a cost element. So, we continue to work and that enables us to deliver the margin that you've seen. Across the margin, there's a lot of levers, right? So working on all of those levers is important and having good handle on cost savings to manage cost pressure from logistics or supply-chain cost, for example, is a must.

<A - Bracken P. Darrell>: Yes.

<Q - Jürgen Wagner>: Okay. Thank you.

<A - Bracken P. Darrell>: Thank you.

Operator

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

<A - Bracken P. Darrell>: Hi, Michael.

<A - Vincent Pilette>: Hey, Michael.

<Q - Michael Foeth>: Congratulations. Good quarter.

<A - Bracken P. Darrell>: Thank you.

<Q - Michael Foeth>: My first question would be the – what explains exactly the relative weakness in Europe in the first quarter, which category in particular? And the second question would be with respect to your operating income guidance, which increased \$15 million, I guess. That can't all be from Blue Micro (sic) [Blue Microphones] (00:32:17), so how much does Blue Micro (sic) [Blue Microphones] (00:32:19) contribute to the guidance increase and how much is from the rest of the business?

<A - Bracken P. Darrell>: I'll let Vincent jump into a second because he's pointing at me, telling me he wants that question. That's the secret behind here. We point at each other. Yeah, so Europe, I mean at the end of the day, it's not

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 Event Description: Q1 2019 Earnings Call

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really – obviously, [indiscernible] (00:32:39) weak in Europe like they were in [indiscernible] (00:32:41). But I would say, generally, we're doing a couple of things in Europe. One, we're moderating our promotion activity in Europe, and so far so good. I would say we'll probably try to keep that up. And that's a kind of a sine wave, a wave you go through. And so we're doing that. And I think that's probably having a dampening effect across the region.

But overall, I think we're doing several changes structurally which I don't really want to totally share, but they're not anything that's secret for any particular reason except there are people involved and we're excited about the changes we're making there. And I think we'll see a really good impact over the next year or two and probably as we go through the year.

<A - Vincent Pilette>: Definitely. I think we'll see improved profit in Europe as we drive those changes.

<A - Bracken P. Darrell>: Yeah.

<A - Vincent Pilette>: And the growth rate by category in Europe is kind at a lower level, but similar than what you've seen on a global basis here, very strong VC, Gaming and weaker Mobile Speakers.

In term of Blue Microphones, as I said, a growing business. Very strong gross margin, at or slightly better than our current corporate average. So, we're very excited about that. [indiscernible] (00:33:51) has been run with a positive EBITDA. We are acquiring it really frankly to develop that business. We think there is a good growth potential here and we're going to invest to make sure we can capture that growth opportunities. So into the overall guidance, we'll close the business by the end of the summer, we'll contribute about 1 point to the topline at or slightly accretive to the gross margin, and then we plan to invest to grow very minimal contribution to the bottom line in FY 2019.

<Q - Michael Foeth>: Okay. So, the majority of the guidance increase is actually from – is actually organic?

<A - Bracken P. Darrell>: Yes.

<A - Vincent Pilette>: It's organic and operational performance coming out of Q1.

<A - Bracken P. Darrell>: That's correct. It's organic. All organic.

<A - Vincent Pilette>: Yeah. Correct.

<Q - Michael Foeth>: Okay. Excellent. Thank you.

<A - Bracken P. Darrell>: Okay. Thanks, Michael.

Operator

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

<A - Bracken P. Darrell>: Hi, Paul.

<A - Vincent Pilette>: Hey, Paul.

<Q - Paul J. Chung>: Hey, Bracken. Hey, Vincent. So this is Paul Chung on for Coster. Thanks for taking my questions. So, yeah, first up, another impressive quarter for Video Collaboration. Are you seeing some increase in competition given the growth numbers you're putting up and that nice margins? I've seen you've been on a very nice run here. Looks like you're on track to hit 40% growth again for the fourth consecutive year, which is pretty impressive. So, how should we think about kind of the growth in the out-years?

<A - Bracken P. Darrell>: Yeah. Thanks, Paul. Tell Paul we said hi. And, yeah, the Video Collaboration is a – it's a monster opportunity. So, it's not an opportunity just for us, it's an opportunity for video conferencing companies that make cloud-based services. It's an opportunity for other people to do hardware like we do. It's an opportunity for everything in between. For the cost of a chair or two in a room, you can video-enable it, and a small fraction of all the rooms out there are video enabled. Sorry to do that advertisement, but I know some of you are not on a video call on a

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regular basis, and I encourage you to at least give us a call and see if we can help you.

Yeah, the long-term secular trend is great. The competition keeps pouring in all the time and we are used to that. That's the business we're in and every category we play in and that's the business we're going to be in here. And so, we see new competitors come in a lot and it just makes us better. Competition also drives market growth. And so, I think as we see more people come into this space, probably the growth will get even stronger and we'll have to be better. And that's why we're investing both on the sales side and on the engineering side. So, I think the long-term potential here is really great.

<Q - Paul J. Chung>: Okay. Great. And then, my second question is can you just quantify the impacts, the value your channel provides? I mean you have a couple of recent use cases, including Jaybird and ASTRO. So, how much of that growth would you say you drove out of the respective businesses by kind of expanding to your large channel? I know there's some channel overlap when you do do these acquisitions.

<A - Bracken P. Darrell>: [indiscernible] (00:37:00)

<Q - Paul J. Chung>: Yeah.

<A - Bracken P. Darrell>: I understand the question, I can't answer it. It's a very difficult – it's a really hard one for us to answer. I would say, generally speaking, we're more global than anybody we're going to buy. So, over time, which doesn't usually happen overnight and hasn't in the case of either of the last few acquisitions, we will get growth expansion, which is one form of channel expansion which is great, and it drives a sustainable growth curve as long term.

Within an existing market, our ability to sell better than the people that we buy, that depends. I'd say in some cases, maybe we have been able to, in other cases maybe we won't. I think it remains to be seen with Blue Microphones whether we will be better at it than they are. I think we'll certainly – long term, I think we'll have potential to go into new channels of development that they're not in and new countries and things. And we've got a portfolio we can connect more directly to those products.

So, I think that we bring a lot on the synergy side of bringing things to market for a small company like Blue Microphones, ASTRO, Jaybird, any of them. It's one of the synergies that we really bring to the table. We also bring a lot potentially to the other end of the equation, which is the cost side and the innovation side.

On the cost side, obviously, we make 140 million products. We sell 140 million products a year. We make 140 million products a year in our factory. And we buy another 50% of our stuff from other people. So, we really have a lot of scale relative to any small company. And our innovation engine is quite good. And as you know, we've been emphasizing design. So, we feel like we can help a small business in several different ways to grow and that's why we are really excited about bringing things like Blue Microphones in.

<Q - Paul J. Chung>: Okay. Great. Thank you.

<A - Bracken P. Darrell>: Thank you. See you, Paul.

Operator

Your next question is from Günther Hollfelder from Baader Helvea. Your line is open.

<A - Vincent Pilette>: Hey, Günther.

<A - Bracken P. Darrell>: Hey, Günther.

<Q - Günther Hollfelder>: Hi. Thank you. Just on – one on the gross margin, a follow-up. I mean, is it possible to also to quantify the impact from product mix given the strength in Gaming and the weakness in Mobile Speakers?

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<A - Vincent Pilette>: Yeah. That's easy. Actually, it's relatively immaterial. We have different dynamics. Again, it's portfolio play, right. So, you have maybe lower than average gross margin, Mobile Speakers being down, but you have Tablet also lower, being up. You have Gaming being up, VC being up and the [indiscernible] (00:39:35). So, product mix overall when you do the normal rate and mixed analysis, it's relatively flat.

<Q - Günther Hollfelder>: Okay. And in terms of currency tailwinds you mentioned, it's basically a management of the gross margin by promotions to drive growth, basically if I compare to the first quarter last year.

<A - Vincent Pilette>: [indiscernible] (00:40:03) If you take currency actually for full year, right, it's favorable in the first half, and then depending on where it is – but versus today's spot rate, it would be unfavorable in the second half. For the full year we've assumed, if I just take the euro to USD exchange rate, similar to last year at \$1.15 exchange rate which right now we're operating under. So, it's a good assumption. And then, it really comes down to that which is improved cost structure to a portion of it would be reinvested into promo and other activities to drive the growth.

<Q - Günther Hollfelder>: And a follow-up on Blue Microphones. Can you disclose the [ph] one PP (00:40:43) of what you're expecting for this fiscal year, what sort of sales growth this would mean for Blue Microphones?

<A - Vincent Pilette>: The business has been growing before we bought them, and we expect them to continue to grow. So the one point includes that growth. And I don't think we'll disclose more in at point of time.

<Q - Günther Hollfelder>: Okay. And last question, can you provide a little bit more color regarding Europe? Also in terms – the improvement you're expecting in the second half, is this broad based or are you targeting special product categories with your actions?

<A - Bracken P. Darrell>: And I would say it's broad based. And we could probably start to dig in if we wanted to talk that level at the country level and things like that. But it's relatively broad based. And yeah, I'm really excited about what we're up to. And it's actually part of playing offense. Some of you may remember back in January, I said we really took a hard look at – Vincent and I have been together for five years. And we ask ourselves, what do we do different for the next five years? And this is part of that. We really reorganize the way we're thinking about regions long term.

And we've put in place new leadership. We're bringing some synergies and really significantly improved processes from one country – from one region to another. And so that's a very broad-based thing. We've got leadership changes as well. And if I just step beyond that, we also talked about that we went through a – the word restructuring has to be used, but we think of it as a realignment which is another effort to say and play offense, really get ahead of the next round of changes. We need to drive long-term growth, and that's affecting Europe as well. So a lot of things in there. And I'm – look, I'm optimistic that we're going to have a good business in Europe long term and across the company.

<Q - Günther Hollfelder>: Okay. Last one, restructuring charges. Anything more to expect here basically booked in the first quarter?

<A - Vincent Pilette>: As I said, there are still a few areas we are reviewing and optimizing. I don't know the output out of it, but if we feel we need to do a little more, we will. As we filed our 8-K, you can see that we put an estimated range for the year of \$10 million to \$15 million.

<Q - Günther Hollfelder>: Okay. Great. Thank you.

<A - Bracken P. Darrell>: Thank you very much.

Operator

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

<A - Bracken P. Darrell>: Hi, Ananda.

<Q - Ananda Baruah>: Hey, guys. How are you?

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<A - **Bracken P. Darrell**>: Good.

<A - **Vincent Pilette**>: Good.

<Q - **Ananda Baruah**>: Awesome. Congratulations on strong results and very crisp execution. Hey, just a couple for me, both with regards to Gaming and Video Collaboration. Bracken, much like you talked to some of what the specific kind of catalysts and dynamics in Video Collaboration have been and, actually, I think you spoke to this for speakers also, are that have been driving sort of increased adoption. Could you do the same? And this is sort of what you're seeing below the covers for Gaming that you've seen maybe over the last – certainly the last quarter, but even the last couple of quarters, kind of the squiggles that you guys are kicking up on the really, really continuing to drive broader adoption, those would be really helpful.

And then, anything additional in Video Collaboration, I'd say, in regard to what you mentioned on the call with regards to kind of like podcast, et cetera – podcasting, et cetera? And then, I have one quick follow-up.

<A - **Bracken P. Darrell**>: Okay. On Gaming, I mean, I think it's a – if you think about it, when you play a PC game, you need a mouse, you need a keyboard, you need a headset. If you're going to stream it, just to stretch over to the other category, you need some kind of microphone. It could be in your headset. If you're not going to use a headset, you need a microphone of some kind that's good enough to pick up the sound well. So, these long-term trends are there.

It's a very global phenomenon. We're seeing the – you can kind of track – just like in music, you can track streaming. You can kind of track the growth of eSports around the world and see how strong this is happening and how broad this is happening. It's happening. I was just looking at something in Japan today, and it's amazing how strongly eSports is driving the gaming industry in Japan. And it's also happening in Latin America. It's happening in Taiwan. It's happening, of course, very broadly in China and Germany and the Nordics. It's everywhere. It is really everywhere. It's happening in Russia.

This is one of the very few global phenomena that is in kind of take-off mode all over the world at the same time and looks like it's not going to slow down. It's probably going down in age as well. If you've got kids around the age of 14, when I started here, I would have said, gosh, this really starts to pick up steam at 13 or 14. Now, it's moving down, I would say. They're probably down to 10, 11, I don't know exactly. But I wouldn't be surprised. So, it's very broad, very deep, and I think it's going to have a really long growth curve.

Video collaboration...

<Q - **Ananda Baruah**>: Yeah. Go ahead.

<A - **Bracken P. Darrell**>: Yeah, sorry.

<Q - **Ananda Baruah**>: Sorry about that.

<A - **Bracken P. Darrell**>: Well, I don't have much to add on video collaboration. I think I said as much as I'll probably say today except I'll just say video collaboration and broadcasting, I think, are two completely different things. One is about communicating point to point with somebody real time, and the other one is about creating. And I think the world of creators is on the rise. And it's going to be – that will be a very long-term secular growth of people who want to create things for other people and we all see it every day. But it's – that's also at the very early days. So, broadcasting is part of that and a microphone is a piece of that as is a webcam.

<Q - **Ananda Baruah**>: And with – my second question is with regard to the Microphones acquisition and really your entrant into that category sort of been a holistic way. Would you like us to think of this as sort of like potential for being kind of a mini-mega category? I say mini-mega because it probably can't be as big as Gaming. Well, maybe it could be as big as Gaming. And so, what's the context in which you like us to think about sort of that one [ph] inside of the (00:47:27) portfolio with regards to breadth and depth potential?

<A - **Bracken P. Darrell**>: I don't know. You can think about it as I think you can assess it for yourselves. I'll tell you how I think about it. I think we're a company of an increasing number of categories with growth potential. Some will

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grow long term, would be very big and powerful; others will grow for a little while and then they'll probably stabilize; others might even shrink. And in some ways a shrinking business can be a beautiful business by the way if it's part of a portfolio where you can manage it for maximizing profitability, investing in other places.

So, I think the microphone business is really interesting. I don't want to reach out in the future and try to predict how big it will be relative to other categories, except to say I love great products. I love great teams, I love great brands and this has all of that. And the dynamics of a world where more and more people are getting in front of a camera of some kind and trying to put something out for other people either live or recorded is a good secular trend for a microphone.

<Q - **Ananda Baruah**>: Are you able to yet discern – I mean, I guess you're just announcing it today so it's not yet closed. But from what you had access to due diligence-wise, are you able to yet discern if what you'll have from an IP perspective allows you to accomplish sort of what you like over the next – for whatever timeframe would be sensible to be able to get a sense, or is this a big enough category where you might say, hey, like in the past like you've done a gaming, we way – there's room potentially for doing additional acquisitions to build out the IP portfolio?

<A - **Bracken P. Darrell**>: The cruel thing about this business is that it was started like our UE business in – this one in particular in 1995. So, you can imagine how much know-how and product development, and expertise they developed over that very long timeframe. And as a result, when we posted this today, I don't think I've ever gotten so many comments from people either directly in my e-mail or on the various places showing up today on how excited they are that we're part of it and how impressed they are with Blue already, not us, but Blue Microphones. So, they're bringing a lot to the table. And I hope that we can add something too. We have a lot of capability in that space as well, but I think they bring a lot with them.

<Q - **Ananda Baruah**>: That's awesome and really helpful, really appreciate it. Thanks a lot.

<A - **Bracken P. Darrell**>: Thanks, Ananda. Thanks a lot.

Operator

There are no further questions at this time. I turn the call back over to Mr. Lu.

Bracken P. Darrell

Okay. I'll just finish up real quickly. I'll go back to something I said kind of midstream with these questions as Q&A. We're playing offense. We're just going to play offense. And a lot of people probably wonder, why in the world did you announce any kind of restructuring today, and it's because we're playing offense. We're not here to try to make things a little bit better all the time. We're building a long-term sustainable growth company in more and more categories. And part of that is we're going to realign when we think it makes sense, and it does right now. And we're going to continue to systematically enter new categories, and we're super excited about what we're doing.

So, thanks a lot for all the questions and engagement, and we'll talk to you next quarter.

Operator

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

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