Logitech Q3 Fiscal Year 2017 Financial Results Management's Prepared Remarks (January 25, 2017)

Logitech is posting a copy of these prepared remarks, our press release, and accompanying slides to our investor website. These prepared remarks will not be read on the call. We refer to non-GAAP financial measures herein. For full GAAP to non-GAAP reconciliation information and cautionary information regarding the use of non-GAAP measures, please refer to "Supplemental Financial Information" in our earnings press release or "Financial Statements only" posted to our website under "Quarterly Results" at http://ir.logitech.com. The live webcast or replay of the question and answer session is also available on our website.

PRELIMINARY RESULTS

Please note that the preliminary results for the three and nine months ended December 31, 2016 contained in these prepared remarks are subject to adjustments, including completion of our evaluation of the changes in the fair value of contingent consideration for the acquisition of Jaybird LLC and other subsequent events that may occur through the date of filing our Quarterly Report on Form 10-Q.

COMPANY COMMENTARY

Following is a summary of the company's comments on key areas impacting Q3 Fiscal Year 2017. The comments are focused on results from Continuing Operations.

The sales growth percentages that follow are in comparison to the same period of the prior year and are in constant currency, except as otherwise specified.

OVERVIEW

Q3 net retail sales grew 13% to $667M, the highest ever quarterly retail sales, with Jaybird contributing about 2 points of the growth. Continued cost management combined with disciplined opex spending drove non-GAAP operating income up 34% to $99M. Non-GAAP earnings per share was $0.56, up 37%. Efficient management of working capital led to very robust cash flow from operations at $147M for Q3.

SALES BY CATEGORY

Our Q3 retail sales growth of 13% came from almost all categories. All three regions contributed to the year-over-year growth, led by a double-digit performance from EMEA and Asia-Pacific.

CREATIVITY & PRODUCTIVITY

KEYBOARDS & COMBOS

Our Keyboards & Combos category saw its 11th consecutive quarter of growth, with sales up 9%. Revenue growth was consistent across all three regions as we continue to improve users' experience with their PCs and other devices.

POINTING DEVICES

Q3 sales in Pointing Devices rose 2%, led by double-digit growth from our high-end mice and a solid performance from our recently introduced silent mice (the Logitech M330 and M220).

PC WEBCAMS

PC Webcams sales increased 4%, marking the 4th consecutive quarter of growth. Our latest C922 Pro Stream webcam has been very well received by consumers and contributed positively to our performance this quarter.

TABLET & OTHER ACCESSORIES

Sales in our Tablet and Other Accessories category fell 29% as the overall tablet market continued to decline. We remain focused on delivering great consumer experiences through continued innovations in the tablet accessories market.

GAMING

In Q3, our Gaming category posted sales growth of 39%, reflecting our leadership position in the exciting PC gaming market and positive contributions from our new product introductions. We continued to see strong momentum from our new Logitech G

Prodigy family of gaming gear and our Logitech G Pro mouse, as well as impressive contribution from our high-end G900 wireless gaming mouse.

VIDEO COLLABORATION

Video Collaboration sales in Q3 grew 38%, with double-digit growth from all three regions. We continue to be excited about the growth opportunities and our portfolio in this still-nascent market, enabled by our leadership position in webcam and audio technology as well as our channel expansion initiatives.

MUSIC

MOBILE SPEAKERS

In Q3, greater channel penetration and solid execution in EMEA drove better-than-expected Mobile Speakers sales growth of 25%, with sales exceeding $100M for a quarter for the first time. For the first nine months of Fiscal Year 2017, Mobile Speaker sales rose 26%, demonstrating our ability to deliver growth from multiple levers, such as a broader portfolio and channel/geographic expansion.

AUDIO PC & WEARABLES

Our Audio PC & Wearables category sales rose 18%, driven by the acquisition of Jaybird. While we are pleased with our double-digit growth, supply constraints for our Jaybird X3 wireless earbuds prevented us from delivering further upside and reaching the earnout forecast. We will continue to invest in developing our wireless earbud portfolio and ensuring that we will meet expected robust consumer demand for Jaybird products.

HOME CONTROL

Our Home Control category sales rose 5%, with Asia Pacific posting another quarter of double-digit growth. Our recent integration of Alexa into our Harmony Hub has resonated well with consumers and drove a meaningful contribution in the quarter.

NET RETAIL SALES BY REGION

Our sales in all three regions – Americas, EMEA, and Asia-Pacific – grew in the quarter, driven by a strong product portfolio and focused execution.

- **Americas.** Our Q3 sales in Americas rose 8%, particularly highlighted by robust performance from Gaming, Mobile Speakers, and Video Collaboration. In fact, our U.S. and Canada sales both achieved record sales in the quarter.

- **EMEA.** Our EMEA region posted another quarter of double-digit sales growth, growing 20%, most notably driven by Mobile Speakers and Video Collaboration.

- **Asia Pacific.** Our Q3 sales in Asia Pacific returned to double-digit gains, with sales up 13% and highlighted by another record quarter from China. In fact, we had our biggest Singles' Day event ever, with sales during that period up 75%.

GROSS MARGIN

In Q3, our non-GAAP gross margin rose 380 basis points year-over-year to 37.4%, marking the 4th quarter of margin improvement and reaching our highest level ever. Our focus on driving continued cost reductions as well as greater supply chain efficiencies contributed to our robust margin improvement. We expect gross margins to seasonally decline in Q4 and Fiscal Year 2017 gross margins to be slightly above 36%.

OPERATING EXPENSES

Q3 non-GAAP operating expenses of $150M increased 11%, while excluding Jaybird, our operating expenses would have been up 6%. Savings in Infrastructure and G&A spending partially offset investments in R&D (up 10%) and Sales & Marketing (up 16%). For Fiscal Year 2017, non-GAAP operating expense ratio will be approximately 26% of sales, as we remain committed to driving towards the long-term annual operating expense ratio target of 25% of sales.

OPERATING INCOME

Our Q3 non-GAAP operating income reached $99M, up 34%. Operating margin of 14.9% was up 300 basis points from last year.

NET INCOME & EPS

With another quarter of double-digit sales growth and better-than-expected non-GAAP operating income, our Q3 non-GAAP net income and EPS increased 38% and 37% to reach $92M and $0.56, respectively. Our non-GAAP tax rate was 9.1%, and we expect our tax rate for Fiscal Year 2017 to be between 9 and 10%, based on our current outlook for sales and profit mix.

BALANCE SHEET AND CASH FLOWS

We exited Q3 with $514M in cash and cash equivalents. We repurchased $21M of stock in the quarter, and in the first nine months of Fiscal Year 2017, we have returned $157M to shareholders in the form of $93M of dividends and $64M of stock repurchases. Cash flow from operations in Q3 was $147M, compared with $166M in Q3 last year. Our cash from operations for the first nine months of Fiscal Year 2017 was $234M, compared to $151M for the same period a year ago. In Q3, our cash conversion cycle of 14 days remained seasonally stable and within our targeted annual range of 20 to 25 days.

Our Q3 inventory of $250M was up $10M from Q3 last year. Our inventory turns were 6.7 times in the quarter (relatively stable versus 6.9 times in Q3 last year).

Accounts receivable were $278M and accounts payable reached $358M at the end of December, both down $6M from Q3 last year. Our DSO were 37 days (versus 41 days in Q3 last year), and our DPO were 77 days (versus 79 days in Q3 last year).

Note: The year-over-year balance sheet comparisons exclude Lifesize.

SHARE COUNT & REPURCHASES

Our basic share count continued to decrease driven by our buyback. Our weighted average diluted share count in Q3 was 165.9M shares, up from 165.2M shares in Q3 last year and up from 165.5M shares last quarter. The increase in dilutive share count is due primarily to the stock price appreciation. In Q3, we repurchased 880K shares for $21M.

FISCAL YEAR 2017 OUTLOOK

On the back of the strong year-to-date performance, we are raising our Fiscal Year 2017 outlook to 12 to 13 percent retail sales growth in constant currency and $225 million to $230 million in non-GAAP operating income.

This compares to our prior Fiscal Year 2017 outlook of 8 to 10 percent retail sales growth in constant currency and $195 million to $205 million in non-GAAP operating income.

FORWARD-LOOKING STATEMENTS

These remarks contain forward-looking statements within the meaning of the federal securities laws, including, without limitation, statements regarding our focus, innovation and investments and demand in our product categories, momentum, growth opportunities, our ability to meet demand in our product categories, our focus on cost reductions, efficiencies and operating leverage, long-term targets for operating expense ratio, operating margin and cash conversion cycle, re-investment of profits, long-term sustainable growth, our sales and profit mix, and our Fiscal Year 2017 outlook for tax rate, operating income and sales growth. The forward-looking statements in these remarks involve risks and uncertainties that could cause Logitech’s actual results and events to differ materially from those anticipated in these forward-looking statements, including, without limitation: if our product offerings, marketing activities and investment prioritization decisions do not result in the sales, profitability or profitability growth we expect, or when we expect it; the demand of our customers and our consumers for our products and our ability to accurately forecast it; if we fail to innovate and develop new products in a timely and cost-effective manner for our new and existing product categories; if we do not successfully execute on our growth opportunities or our growth opportunities are more limited than we expect; if sales of PC peripherals are less than we expect; the effect of pricing, product, marketing and other initiatives by our competitors, and our reaction to them, on our sales, gross margins and profitability; if our products and marketing strategies fail to separate our products from competitors’ products; if we do not fully realize our goals to lower our costs and improve our operating leverage; if there is a deterioration of business and economic conditions in one or more of our sales regions or product categories, or significant fluctuations in exchange rates; the effect of changes to our effective income tax rates. A detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Logitech’s periodic filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the fiscal year ended March 31, 2016 and our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2016, available at www.sec.gov, under the caption Risk Factors and elsewhere. Logitech does not undertake any obligation to update any forward-looking statements to reflect new information or events or circumstances occurring after the date of these remarks.

USE OF NON-GAAP FINANCIAL INFORMATION

To facilitate comparisons to Logitech's historical results, Logitech has included non-GAAP adjusted measures, which exclude share-based compensation expense, amortization of intangible assets, purchase accounting effect on inventory, acquisition-related costs, change in fair value of contingent consideration for business acquisition, restructuring charges (credits), gain (loss) on equity-method investment, investigation and related expenses, non-GAAP income tax adjustment, and other items detailed under "Supplemental Financial Information" in our earnings press release or "Financial Statements only" posted to our website under "Quarterly Results" at http://ir.logitech.com. Logitech also presents percentage sales growth in constant currency, a non-GAAP measure, to show performance unaffected by fluctuations in currency exchange rates. Percentage sales growth in constant currency is calculated by translating prior period sales in each local currency at the current period's average exchange rate for that currency and comparing that to current period sales. Logitech believes this information, used together with the GAAP financial information, will help investors to evaluate its current period performance and trends in its business. With respect to our outlook for non-GAAP operating income, most of these excluded amounts pertain to events that have not yet occurred and are not currently possible to estimate with a reasonable degree of accuracy. Therefore, no reconciliation to the GAAP amounts has been provided for Fiscal Year 2017.

USE OF SELL-THROUGH DATA

Logitech relies on reports from third-parties for data on its product sell-through and inventory information. While Logitech believes this information provides meaningful perspectives on sell-through and inventory trends over time, this information is not subject to Logitech's internal control systems and Logitech cannot assure investors of its accuracy.