FINAL

Bloomberg Transcript

Q3 2021 Earnings Call

Company Participants

- Benjamin Lu, Vice President Investor Relations
- Bracken P. Darrell, President and Chief Executive Officer
- Nate Olmstead, Chief Financial Officer

Other Participants

- Alex Duval, Analyst
- Analyst
- Andreas Mueller, Analyst
- Asiya Merchant, Analyst
- Erik Woodring, Analyst
- Joern Iffert, Analyst
- Michael Foeth, Analyst
- Paul Chung, Analyst
- Reto Huber, Analyst
- Serge Rotzer, Analyst
- Tom Forte, Analyst

Presentation

Bracken P. Darrell {BIO 3403495 <GO>}

Good morning, everyone.

Benjamin Lu {BIO 15184293 <GO>}

Good morning, Bracken.

Bracken P. Darrell {BIO 3403495 <GO>}

Good morning, Ben. How are you?

Benjamin Lu {BIO 15184293 <GO>}

Very good. So, let me just start...

Bracken P. Darrell {BIO 3403495 <GO>}

Did you get my note?

Benjamin Lu {BIO 15184293 <GO>}

Bracken, let me start this call.

Bracken P. Darrell {BIO 3403495 <GO>}

You bet.

Benjamin Lu {BIO 15184293 <GO>}

Okay. Thanks, everyone. Welcome to Logitech's Video Call to discuss our financial results for the Third Quarter of Fiscal Year 2021. Joining us today are Bracken Darrell, our President and CEO and Nate Olmstead, our CFO.

During this call, we may make forward-looking statements, including with respect to future operating results under the Safe Harbor of the Private Securities Litigation Reform Act of 1995. We are making these statements based on our views only as of today. Our actual results could differ materially and we undertake no obligation to update or revise any of these statements.

We will also discuss non-GAAP financial results. You can find a reconciliation between non-GAAP and GAAP results and information about our use of non-GAAP measures and factors that could affect our financial results in our press release and our filing with the SEC, including our most recent annual report and subsequent filings.

These materials as well as the prepared remarks, and slides and webcast of this call are all available at the Investor Relations page on our website. We encourage you to review these materials carefully. Unless noted otherwise, comparisons between periods are year-over-year and in constant currency, and sales are net sales. This call is being recorded and will be available for replay on our website.

I will now turn the call over to Bracken.

Bracken P. Darrell {BIO 3403495 <GO>}

Thank you, Ben, and thanks for joining us. Q3 was our biggest quarter in company history, and this will clearly be the biggest year in Logitech's history. Last quarter we predicted that as the world opened up few companies would opt for a full work from home or a full work from the office approach. In short, most companies we said are likely to adopt a hybrid model with many of us working a few days a week in the office and a few days at home. With another quarter behind us, I have greater conviction that most companies will move to a hybrid at work at home model.

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

I had a meeting with them was 60 other CEOs this week. And while we didn't take a poll, I would guess the vast majority of them will adopt hybrid work as a new normal. Logitech is well-positioned to serve customers moving to hybrid work. We can upgrade and improve workspaces at home and in the office, and the explosive growth of video calling, drives the need for high-quality video at home, and office workspaces and in meeting rooms.

For Logitech, that simply means growth. The global trend propelling gaming toward becoming the largest collection of spectator and participant sports in the world continues. Over a billion people watched some part of the League of Legends Final last quarter, a billion people. Over 100 million people watched the final live, the same number as the Super Bowl last year. Streaming and creating is poised for long-term growth as well. There are now 1.8 million podcasts to listen to, and untold TikTokers, Instagramers and streamers to watch. These are examples of the democratization of digital content that we've talked about for some time, and this trend grew into the pandemic, during the pandemic and will surely grow after the pandemic. Given the increasing pervasiveness of this type of content. Streaming and creating could one day become one of our biggest product categories. In other words, we are really well-positioned for the long-term.

Let's look back at our third quarter that just ended. We delivered another strong quarter with sales of 80% and non-GAAP operating profits more than tripling but. To put this in context, this quarter's year-over-year sales volume growth is greater than the total growth from the three prior years combined. On top of that, Q3 profit was more than we delivered in all of last fiscal year. Our Creativity and Productivity categories delivered a mid 30% growth in Pointing Devices and Keyboards and Combos. The transition to a work from anywhere culture and a mixed learning environment creates increased peripheral attach opportunities for us. I guess the large and growing PC installed base. And customers who upgrade their devices can benefit from improved aesthetics, performance, ergonomics or all the above. We simply have upgrade opportunities across every workspace in the world.

PC Webcam sales more than quadrupled in Q3 and year-to-date sales have more than tripled. While these growth rates may seem tremendous, and they are, the incremental units we sold this year are just a drop in the bucket compared to an installed base of nearly 600 million monitors and almost 1.5 billion PCs. 600 million monitors, 1.5 billion PCs to support the growing prevalence of video communications, we're working to expand our capacity to support the higher demand for Logitech Webcams. As video conference use exploded -- as video conferencing is exploded, the opportunities to innovate our camera technology have come into sharper focus. We're the market leader in webcams and we're increasing our product investments to provide customers even better experiences than they have today.

Tablet and Other Accessories sales for the quarter increased more than fourfold to $238 million, the first time we've achieved sales over $100 million in a single quarter. The real highlight this quarter was the tremendous growth we delivered in our Education Tablet Keyboards. Governments, schools, educators, parents and students around the world are all adapting to a digital learning environment. While we have significant demand from various countries, Japan was one of the biggest contributors to our Education Tablet Keyboard sales in Q3. We mentioned last quarter that Japan's Education Ministry has

FINAL

Bloomberg Transcript

allotted over $3.5 billion to improve schools for online teaching, and this program is expected to last through the remainder of our fiscal year.

Video Collaboration sales more than tripled to another record high of $293 million. Sales of our conference room products also delivered impressive quarter, doubling year-over-year. As I said last quarter and to lead off these remarks, companies are starting to reconfigure their office layouts and work cultures to enable workers to collaborate remotely and flexibly. I say started because most people are not back at offices yet. Not only are companies video-enabling their own site offices, but they are equally if not more quickly, equipping their employees with enterprise grade webcams and headsets, both for the home and for the office workspaces. Just last week, we announced Mini for smaller rooms, Rally Bar for medium-sized rooms and RoomMate with our current Rally system for larger rooms. In addition to exceptional audio and video, one of the key features of these products is to run these products in appliance mode, so that you can have Zoom room or Microsoft Team rooms, for example, without a separate monitor. This greatly simplifies the rollout of these products and allows IT managers to scale out deployments to every room. We're ready for when people go back to work. Based on the feedback from dozens of large enterprise customer beta trials, we believe this new portfolio raises the bar for Logitech, and the entire VC industry.

Gaming sales grew 73% in this quarter. Growth was strong across all three regions, and across all of our gaming categories, on the back of several new product introductions, which helped us achieve a record high market share in PC Gaming. We believe that the deep integration of gaming into consumers digital and social networks will greatly enhance the stickiness of gaming for years to come.

Streamlabs had another strong quarter with continued growth in subscribers and paid conversion. We couldn't be more excited with the Streamlabs team, George, I hope you heard that, who are teaching us capabilities as they experiment with various initiatives to increase user engagement and customer acquisition.

Blue Microphones and retail headsets also had another great quarter, with sales growth of both up triple digits versus the same quarter last year. Mobile Speakers and Smart Home categories remain soft this quarter, as we expected. You know that we actively manage our portfolio and as such, we continue to focus our investment priorities on other fast-growing market opportunities and will manage these two product categories to maximize profitability rather than growth.

Now, let me turn the call over to you, Nate, to walk through the rest of our key financial metrics in Q3.

Nate Olmstead {BIO 21036514 <GO>}

Thanks, Bracken. We delivered another excellent quarter of financial results on the strength of our diverse product portfolio, the global reach of our sales and marketing capabilities, and the execution of our operations team. Our results were strong across nearly all dimensions. We grew revenue significantly and gained share across our

FINAL

Bloomberg Transcript

categories, expanded gross margins, invested significantly in our strategic priorities and brand, and delivered more than $500 million of free cash flow. Gross margin increased 760 basis points to 45.2% in the quarter. The gross margin improvement was the result of very strong sales volume, reduced levels of sales promotion, favorable product mix and some tailwinds from currency exchange rates. While our recent gross margin has been above our target range, I do expect margins will come down from these highs in the quarters ahead. As supply normalizes and retail stores continue to reopen, we plan to actively pursue opportunities to invest in joint marketing and appropriate levels of promotion to drive continued growth. We have always said that we are focused on delivering sustainable and long-term growth while keeping margins at levels that we believe strike the right balance of profitability and investment. And so it is with this philosophy in mind that we will continue to manage the business going forward.

Non-GAAP operating expenses increased nearly 50% to $278 million and yet OpEx reached a record low of 16.7% of sales. As we discussed last quarter, we ramped up the pace of investments in sales and marketing and R&D and we'll do so strongly again in Q4. Our sales and marketing spending increased over 50% year-over-year as we deployed investments against various marketing priorities including a Global Brand Awareness campaign and local country and category-specific marketing activations. We utilized new marketing platforms and bolstered our influencer marketing campaigns. Go-to-market investments also included the continued expansion of our sales coverage for video collaboration, education and the overall B2B channel. All these activities will continue in the March quarter, as we leverage the strength and investment capacity from our current demand to improve our potential growth over the longer term.

R&D spending increased 23%, a growth similar to the prior quarter, as we continue to reallocate engineering resources from mature and declining categories to faster-growing opportunities. I'm pleased with our pace of innovation and we announced several significant new products, including the Conference Camera solutions, Bracken mentioned, exciting gaming peripherals and refresh mice and keyboards over the recent months and we have a strong roadmap of new products teed up for FY '22 and FY '23.

G&A expenses rose 73%, as we invested in our IT and customer care infrastructure to support a vastly higher sales volume. And we also launched a few short-term investments and projects that should wind down by the end of the fiscal year. The teams did an incredible job and scaling our business so quickly and we have invested more in the areas to help serve our growing customer base. While we are accelerating our investments into our business, we will maintain the financial discipline you have come to expect from Logitech. A significant portion of our second-half investment is variable allowing us to align our spending with future gross profit. And while we're managing risk by variabilizing our costs where possible, we also believe that fixed cost investments in the business are essential to help drive long-term growth and we plan to continue to enhance our marketing capabilities, brand awareness and selling capacity.

Now, let me move to our cash flow and balance sheet. We delivered another strong quarter of operating cash flow, which reached $530 million, up from $181 million in Q3 last year. These results bring our year-to-date operating cash flow to over $900 million. Record fast inventory turns and healthy cash collections led to a cash conversion cycle of

FINAL

15 days. Our cash conversion cycle is typically lowest in this quarter in Q3 due to the faster inventory turns during the holiday. So you should not be concerned to see an increase in this metric next quarter. Our cash balance is nearly $1.4 billion exiting Q3. And in addition to funding acquisitions, share repurchases and dividends, we view our strong balance sheet as a strategic tool to support our growth via investments in both supply and expanded manufacturing capacity. And once again, as with prior quarters, our operations team executed the strategy well, all while adhering to strict COVID safety measures and travel restrictions. Rounding out uses of cash in the quarter, we repurchased $50 million of our own shares, bringing our year-to-date share repurchase total to $72 million.

And now, I will return the call to Bracken for guidance and his closing remarks.

Bracken P. Darrell {BIO 3403495 <GO>}

Thank you, Nate. Nice job. This morning we announced an increase in our fiscal year '21 outlook, which implies it for the final quarter of the year, our Q4 sales grew 40%, 50% and our non-GAAP operating income will increase about 30%. This means that our revised fiscal year '21 outlook will be for sales growth of 57% to 60% and our non-GAAP operating income to be approximately $1.05 billion.

This is up from our prior annual outlook of 35% to 40% sales growth for the year and a range of $700 million to $725 million in non-GAAP operating income. You've all come to appreciate Logitech for our commitment to delivering sustainable long-term growth. That commitment remains firm. We see so many new and expanded market opportunities, as we emerge from the pending it that we will invest aggressively to capture the growth potential. So the next several years will be so exciting and I can't wait to innovate expand and drive change.

And with that, Nate and I are ready to take your questions. Ben, can you queue them up.

Benjamin Lu {BIO 15184293 <GO>}

Thank you, Bracken.

Bracken P. Darrell {BIO 3403495 <GO>}

Thank you.

Questions And Answers

A - Benjamin Lu {BIO 15184293 <GO>}

Joern, UBS. Your line is now open.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Hi, Joern. How are you?

Bloomberg Transcript

FINAL

Bloomberg Transcript

Q - Joern Iffert {BIO 15374623 <GO>}

Hi. Thanks for taking my questions. And Hello to you Bracken and Nate. And three questions, please. The first one is, taking an early view in fiscal year '22, I mean do you see the risk that we have some pull forward demand in the Gaming end market? And also in Video Collaboration, where corporates are doing the homework, preparing for when employees are coming back to the office?

Second question would be, based on the gross profit margin, and just from a technical point of view, why was it not higher quarter-on-quarter, given the higher scale benefits and higher FX benefits? And also on point number three, can you elaborate a little bit more on your incremental marketing spend of $50 million quarter-on-quarter, was this headcount related and what exactly is this Global Brand Campaign you are rolling out at the moment? Thanks a lot.

A - Bracken P. Darrell {BIO 3403495 <GO>}

I hope that everybody else is not experiencing the slight negative feedback I can observe, but I bet you are. So if one of us is talking and it gets kind of choppy please don't hesitate to re-ask the question. I'll jump in, and then, Nate, you and I can counter back and forth.

Now, we are we experiencing pull forward demand in gaming and VC. The demand for gaming has been so long-term and so strong for many, many been years, and I think, well, it's certainly the case that people are playing a lot of gains during the pandemic. A lot of what drives the growth of gaming is really games themselves. Yeah, you'll remember the Fortnite effect a few years ago, and then before that, I would say, League of Legends, probably the big phenomenon and there will be more. So I'm really optimistic that gaming is just going to keep chugging along and growing long-term. We're not going to guide anything today for next year. That will come in the next few weeks, but I'm really optimistic gaming long-term. I would say, I'm just as optimistic and not (inaudible) about VC. VC is, if you look at just the personal video enablement, a typical person as a webcam it's not very good and yet we sell -- and if you look at the number of webcams we sell relative to the number of monitors and the number of PCs out there 600 million monitors, 1.4 billion PCs. This is just a drop in the bucket. It's up to us to figure out how to unlock the demand that ought to be out there for webcams long-term because you get such a better experience. Many of you right now are looking off at the distance instead of looking right that right into camera, for example, or the quality of the picture is not very good and you're looking at yourself about four, five times a day -- four, five times a minute instead of four, five times a day. So I think we have actually -- and then in the office, the VC -- the video enablement of office is just -- it's brilliant start. I mean if you think about what's going to happen when people go back into these hybrid work environments, I can't believe you're not going to see a very strong growth of video conferencing long-term.

So I'm really optimistic about it. I'll let you take the gross margin point. Just a second. Although, I'll give you the circuit the answer, which is -- well, I won't, I'll let you do it. Incremental marketing spending, it's a combination. And Nate mentioned in the script, we're -- you know us, we try to be very aggressive and risk-managed. So a lot of this spending we're putting it is variable. So we're always ready to -- if it's working, we'll keep -- we'll double down on it. If it looks like it's not as effective as we'd like we'll pull it back.

FINAL

Bloomberg Transcript

But we also are making long-term fixed investments. We have so many opportunities right now around the world. So we're going to keep making those. You want to add anything -- any of those, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

Sure. Yeah, let me just on the gross margin question, Joern, and again apologize for the feedback if you're getting as well. The primary difference sequentially I think, Joern, would be mix of products. And that in Q3, we mentioned we had a very strong EDU quarter which tends to be a little bit lower gross margin than other parts of the portfolio, so very good business for us.

So that's the primary reason why I suppose you could say, gross margins were not higher, although they were quite strong. And then as Bracken said on the marketing side, I mean frankly we couldn't add much headcount in one quarter or two to drive that kind of cost increase, so most of that was variable on the marketing side. And as Bracken said, I think it could become a long-term investment for us. We'll judge the effectiveness of it. But as we've been saying, so many of these trends, we really firmly believe our long-term multi-year growth drivers for us and when we have confidence in that we'll make fixed cost investments to support those. It simply wouldn't make any sense, even if there were a quarter where demand pulled back. If we believed in the long-term strength of that trend, we'd want to continue to invest through that potential slowdown to make sure that you're competitive over the longer-term.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Absolutely.

A - Benjamin Lu {BIO 15184293 <GO>}

Thanks, Joern.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thanks, Joern.

A - Benjamin Lu {BIO 15184293 <GO>}

Paul from JP Morgan. Your line is now open.

Q - Paul Chung {BIO 20654199 <GO>}

Hey, guys, great quarter. Thanks for taking my questions.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thanks, Paul.

Q - Paul Chung {BIO 20654199 <GO>}

FINAL

Bloomberg Transcript

So first up, can you talk about the pricing dynamics across segments, given your elevated demand? Did you raise or are you raising prices in any segments or is the gross margin benefit mostly product mix and scale with some FX in there? And I'll follow up.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Okay. The answer is, no. We have not raised the prices. We are doing a lot less promotions. You see our promotion numbers now and the gross. Now, we really pulled way back on the promotion levels and we stayed back. I hope we can keep at least some of that benefit coming out of -- I'm sure some promotion will go back.

That certainly has that. I'm sure it has an effect on our average pricing, but most of the -- most of our pricing benefit is really as you said it's mix, mix within category and mix across category. Yeah. And I think, Paul, maybe to where you're going is, the sustainability of these gross margin levels. As I mentioned in my comments earlier, do you expect gross margins will come back down towards probably the high-end of our prior range? There are some things in there that are probably more sustainable like some of the mix benefits of growth in VC, it's a nice category from that standpoint. But I think we're going to need to move back to more reasonable levels of promotion as supply and demand normalize, and so that again is included in our outlook and something I would expect to see in the near-term and in the quarters ahead.

Q - Paul Chung {BIO 20654199 <GO>}

Okay, thanks for that. And then on VC more and more enterprises are looking to switch to Zoom enabled rooms. Is your market share kind of accelerating in the larger conference rooms now? What's been the kind of initial feedback on the RoomMate product? Thanks.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah. So yeah, more and more companies are going to Zoom, and Microsoft and to Google. So there's all the kind of plug and play solutions that are cloud-based are all growing really well. We've -- you asked about our market share in large rooms, it's a little hard to judge that exactly. I would say, first of all, large rooms are a really small percentage of the total. But we've now got phenomenal products for large rooms and I think we're definitely growing in large room, we'll see. But overall, as you see our growth has been extremely strong and we're super optimistic about all of our product portfolio, including the newest reset that I'd mentioned in the earlier in the call -- not reset, new introductions.

I mean I think we're really raised the bar on the industry. You asked that feedback we're getting from beta customers and it's been very, very strong, very strong. Very strong.

A - Nate Olmstead {BIO 21036514 <GO>}

Yeah. I mean I think our performance in those larger rooms has been very good, as you can see the conference cameras continued to grow quite well. I think there's a lot more room for us there, Paul. We've been adding capacity, selling capacity, more coverage into large accounts and we've had some really nice large wins. But I think there is a lot of room for us to continue to grow in those spaces.

FINAL

Bloomberg Transcript

Q - Paul Chung {BIO 20654199 <GO>}
Okay, great. Thank you.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Thanks, Paul.

A - Benjamin Lu {BIO 15184293 <GO>}
Alex from Goldman Sachs. Your line is now open.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Hey, Alex.

Q - Alex Duval {BIO 16682293 <GO>}
Hi and congrats on the robust results. Two very quick questions. Firstly, just on the guidance for the next quarter, you seem to be implying seasonality, which is meaningfully below what we'd see normally, and just given that, obviously, we continue that many countries to be in a lockdown scenario in the current fiscal quarter I just wondered what plays into that in terms of that sort of sub-seasonal forecast?

And then secondly, it's interesting you talked about governmental spend, particularly in Japan, we've seen a few news articles, also in terms of other regions talking about home education and peripherals required for that. And I wondered if you could talk about what you're seeing on a global basis and if that could go beyond the current quarter which you obviously referenced?

A - Nate Olmstead {BIO 21036514 <GO>}
Bracken, you want me to take the -- you want to start, but then I'll take the guidance, sure.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Yeah, you bet. I'd say on the education front, yes we -- there are lot of governments around the world that are investing now in education and in technology for education, and I don't think that's going to let up. And we see it as a lot more than a one-quarter trend, we think it's a long-term trend. We are excited about the education space.

A - Nate Olmstead {BIO 21036514 <GO>}
Yeah. Alex, on the guidance and the seasonality sequentially. Honestly, I do like to look at our business in terms of typical seasonality this year has sort of not been typical. And you saw that, in fact, in Q3 where we grew sequentially about 33%, which was pretty well above our typical seasonality, Q2 was about typical seasonality.

So you're correct. Our outlook for Q4 does imply a sharper slowdown than what we have seen in recent times, Q3 to Q4, but I think it's appropriate. Just, again, given the strength

that we had this quarter and some of this increased promotional spend, which we expect to reactivate that will also put a little bit of pressure on revenue sequentially.

So nonetheless, it's still implies 40% to 50% growth year-over-year into a quarter where -- as you know Q4 of last year, we started to see some pretty strong pickup in demand. So I think the guidance looks pretty reasonable.

FINAL

Q - Alex Duval {BIO 16682293 <GO>}
Great. Nate, thanks.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Thanks, Alex.

A - Benjamin Lu {BIO 15184293 <GO>}
Hi, Erik, from Morgan Stanley. Your line is now open.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Hi, Erik.

Q - Erik Woodring {BIO 19492555 <GO>}
Awesome. Thanks, Ben. Hey, Bracken and Nate. So, two questions on my end. First, congrats on the quarter. So for the second consecutive quarter we kind of saw sell-in meaningfully outpace sell-through, so just wanted to understand kind of the dynamic there, why that has been the case and whether you think that has to reverse in coming quarters? And I have a follow-up.

A - Nate Olmstead {BIO 21036514 <GO>}
Sure. Do you want to take that one, Bracken?

A - Bracken P. Darrell {BIO 3403495 <GO>}
Yeah, you can go ahead.

A - Nate Olmstead {BIO 21036514 <GO>}
Yeah. It's a good point. There are really two drivers of this, primarily. The first is that sell-through is reported on a gross basis, meaning those numbers do not reflect promotions, it's before promotions. And so as we've talked about, we got some benefit from the reduced promotions and so you see that in net sales. You don't see that in the gross sales or in the sell-through numbers. So that's the first reason why you'd have some difference. The other would be channel inventory. So, sell-in to replenish channel inventory is still at very reasonable levels, and in fact, still short in some categories, like last quarter. So that's really -- the two drivers there would be the difference in the calculation because one is before promotion, and one is after, and then the other would be channel fill. But again,

Bloomberg Transcript

channel inventory is at very appropriate levels and feel good about where we are -- how we look, going into the March quarter.

Q - Erik Woodring {BIO 19492555 <GO>}

Okay, super helpful. Thank you. And then maybe if I just turn to the balance sheet, it's kind of a two-part question. So one, on the cash balance, obviously, you have more than $1 billion of cash. So just looking -- just wondering if you'd -- if you're looking to be more aggressive in deploying that cash and how you would do that?

And then the second part is just again your inventory levels are nearly double what they were at the end of last year. So is that a sign you're holding on to more inventory for perhaps direct-to-consumer purposes, is that going to be worked down over the coming quarters? Just any color on both of those line items? Thanks, guys.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Let me pick the first one, Nate, and you look at the -- we have the same approach with our cash that we had before. We're obviously paying a dividend and we'll surely increase the dividend, I can't speak for the Board, but we normally do in September, but at kind of a normal level.

The second thing is we'll keep doing stock buybacks and I'm sure we will want to keep doing that, but again I can't speak for the Board, but the rest of the Board, but I expect that in terms of M&A that's the key. We continue to look hard for a great strategic opportunities and they are out there. Now, will they be large enough to take that kind of cash, we're always looking at small, medium and large. It takes -- the stars have to really align to find something large. So we're going to stay after it, it is lot cash. We're generating a lot of cash but I'd look -- we'd love to put it to use strategically.

But we have so much organic opportunity too, we're certainly going to keep plowing into that. And you might want to add to that too, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

Yeah, and I think the other thing that's been important and we've mentioned this couple of times is just the use of that cash to invest in working capital, which really gets exciting.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Which is related to his question, yeah.

A - Nate Olmstead {BIO 21036514 <GO>}

Yeah, really gets to your second question on inventory. Yes. Obviously, the inventory balances has increased, but we're supporting much higher volume. So if you look at days of inventory that's continued to come down. We had our actually best inventory turns in history this quarter. And again, I'd want to point out, but I think our operations team has done such a nice job. Not only have they scaled -- help scale the business to capture the

FINAL
Bloomberg Transcript

FINAL

incremental volume that we've had, but they've also continued to drive operational improvements at the same time.

So, this hasn't just been an environment where we're chasing supply, we're actually trying to make our -- stay on path with our structural improvements whether that's manufacturing diversification into other countries, whether that's efficiencies in our supply chain, cost reductions, things that benefit us over the longer-term. And in fact, some of that is what's driving the improved inventory performance that we see right now. So I think we're getting some benefit on inventory from the higher sales velocity. But we're also making efforts to improve think structurally so that we can continue to be more efficient on working capital going forward, but no concerns for me on the inventory.

Again, it's, all appropriate given the increases in volumes. It's all fresh, it's on fast-moving products. So feel very good about where we're at.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Absolutely.

Q - Erik Woodring {BIO 19492555 <GO>}
Awesome. Thank you, guys.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Thanks, Erik.

A - Benjamin Lu {BIO 15184293 <GO>}
Thanks. Our next question comes from Asiya Merchant from Citigroup.

Q - Asiya Merchant {BIO 20247269 <GO>}
Great.

A - Nate Olmstead {BIO 21036514 <GO>}
Hey, Asiya.

Q - Asiya Merchant {BIO 20247269 <GO>}
Hey, good morning, everyone. Thanks for the opportunity. A couple of quick questions. On promo spending you guys talked a little bit about resumption in promo spending at some point. Are we looking at that in the March quarter, or do you think just given still all the COVID lockdowns, et cetera, this is likely going to be a fiscal '22 event? If you can parse out the impact of lower promo spending in any way on margins year-to-date or even in third quarter that would be great?

And then I just have a follow-up for Bracken as well on Streamlabs. He mentioned that, obviously, that's going well for you. Any anecdotes you can share there on how that's

Bloomberg Transcript

driving higher user engagement/higher use of your peripherals and when do you see that services or subscription really showing up as maybe a meaningful driver of revenues across your portfolio? Thank you.

A - Bracken P. Darrell {BIO 3403495 <GO>}

You will take the first, Nate, and then I'll take the second.

FINAL

A - Nate Olmstead {BIO 21036514 <GO>}

Sure. On promo, I'll be a little bit careful on this one, obviously, because this can be something that's important for competitive reasons, but I'll just reiterate, I don't think the current levels of promotion are sustainable. I think it's healthy for us to have some promotion to continue to drive growth and invest in our categories. So I'd say I would expect to start seeing that promotion turn on again in the March quarter. But we'll see how things look. It's something that we can do quickly and we can manage dynamically. In terms of the impact on the margins themselves, it was the largest driver --lower promotions were the largest driver of the year-over-year improvement in gross margins. It's a bit of an unusual year. So I'll step maybe away, normally we wouldn't talk too much about the size of that impact, but it's been kind of an unusual year in that respect, so I think it's good to share. It's probably about a five to six point impact in our gross margins favorably year-over-year from lower promotions, similar to what we saw last quarter.

So it's important to keep that in mind as we look forward, again, we've benefited from it. I think we are managing it wisely, but that's something that we're going to have to continue to evaluate in the future.

Bloomberg Transcript

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah. And on your question about services in general and Streamlabs in particular. Sreamlabs, a little bit of color on that. We're offering a subscription service now and that shift in services is doing really well. I mean, the team has done an extremely good job mining that subscription service opportunity I'd say that -- and so it's growing really well. I'd say the more important part of those not per se the exact service we're selling today or even the size that business, it's the learning. So we're really learning hard on this because we're also offering services quietly in our Video Conferencing business. We've got things in the works in gaming. We've got some things in the works in CMP. I wouldn't expect any of that individually or collectively to become a really big number next year or even the year after that, but I think I'll predict that what's going to happen with our Services business that over time we're going to be -- you're going to -- we're going to be working, working, working you're going to hear a little bit about it, and then one day it's going to really pick up and -- because we're in a learning mode and we want to have a stickier relationship with our customers across every business. So stay tuned. It's a long-term play. I am super excited about it. I'll remind you that when I first joined Logitech, I went down to meet with a bunch of a lot of venture capitalists and get kind of advice on what Logitech should do and at the time, so many of them were investing deeply into hardware-enabled service businesses and I kind of got from some of them kind of a pat on the head and said, you guys probably should -- you ought to try and find another job because one that we're coming for you. And I walked out thinking, gosh, we got to turnaround to do and that's easier said than done, I think I'll just focus on what we're doing and do it well in

hardware. Years later, we're worth a lot more than 10 times we were worth then, and a lot of those investors have gotten out of hardware. But they are right that services are going -- it's just a question of timing and service is going to be a really critical part of so many experiences you buy and we know that. And so we've been investing, we're going to keep investing, we're going to build that. So I'm excited about the future that involves services, but it's going to take time as yet to develop.

FINAL

A - Benjamin Lu {BIO 15184293 <GO>}
All right. thanks for your questions. Okay, great. Thanks.

Q - Asiya Merchant {BIO 20247269 <GO>}
Thank you.

A - Benjamin Lu {BIO 15184293 <GO>}
Our next question is from Serge from Credit Suisse.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Hey, Serge.

A - Benjamin Lu {BIO 15184293 <GO>}
Serge, your line -- we cannot hear you.

A - Bracken P. Darrell {BIO 3403495 <GO>}
How are you, Serge?

Q - Serge Rotzer {BIO 4734915 <GO>}
Can you hear me now?

A - Benjamin Lu {BIO 15184293 <GO>}
Yeah.

Q - Analyst
Sorry. So always me having the problem fix the hardware. So you should teach me once. Okay. Congrats, guys, to your great results. I have several question at least two, I would like to ask now. You already mentioned that this order from Japan has been a one-off at least in the press release. Before you mentioned, now, you could expect more to come of that. So I'm wondering, can you give me the size of this contract, well, not be in detail, but that we get a feeling what this means? And do you see other such tend -- one-time orders in mice, keyboards or VC? And are they coming also from corporates and not only from government, to give some color here?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Bloomberg Transcript

FINAL

Bloomberg Transcript

Yeah, I don't think we've disclosed. I think we should probably disclose the size of that order in Japan. But what I would say is, we do see very sizable orders coming from corporates. I still think it's kind of early days for that. We've had some bulk buying in mice and keyboards that are -- that's really exciting.

And I think -- but I don't think those are kind of temporary things. I think you're going to see some of that will come as people are (inaudible), people are at homes, but it's also going to start to happen in the office. We never had a direct relationship with a lot of the largest companies in the world because we just didn't have the scale or hadn't made the decision to have scaled the sales force selling into the enterprise, for example. I'm moving past education for a minute, and the same thing was true of education and because of VC, this is one of the synergies we're creating now for the future, because of VC we now have a direct conversation with the largest companies in the world and that enables us to talk about things like our workspace, our desktop business, mice and keyboards and webcams in a way we never did before.

So our market shares were under-developed in the enterprise business, in B2B in general, and we are completely committed to changing that going forward. So I think that's one of the growth opportunities we have ahead. In education, I think there is -- most people that are involved in the education around the world, will tell you this, while the move -- while students at home, all the time is probably not going to change remote work and more technology-enabled work is the future. And so I think the investments are going now in education in Japan are kind of exemplify what's going to happen, what starting to happen around the world in places like Germany and other countries that we'll invest and keep investing in education technology and we're going to be part of that.

So we are putting ourselves in position for that.

Q - Serge Rotzer {BIO 4734915 <GO>}

Okay. Very, very good. A follow-up question is, you mentioned that you still have some supply constraints, mainly in the webcams. Is this for enterprise webcams or only consumer webcams? And do you have any other product categories where you are short and when do you believe that you are coming out of this situation?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah, it's really in both. We also some shortages in microphones, a few others -- a few other places. In terms of when we think could come out of it, I'm almost embarrassed to predict that. Now, I think predicted every quarter we're going to be out of it in the quarter two and I've been wrong. The demand has been stronger than we thought in each case and continue to be very, very strong. We are expanding our capacity both in May -- in assembly or making, as well as in the components we need.

Yeah, I would guess sometime next year, we'll see really get to full capacity on webcams. You want to add anything that, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

No. I think that's right.

Q - Serge Rotzer {BIO 4734915 <GO>}
Next year fiscal or calendar?

A - Bracken P. Darrell {BIO 3403495 <GO>}
Fiscal.

Q - Serge Rotzer {BIO 4734915 <GO>}
Fiscal. And sorry, I guess the last question. Where is the main bottleneck, is it components or is it in production or it...?

A - Bracken P. Darrell {BIO 3403495 <GO>}
Right now it's moved a little bit. I'd say we're now, pretty good -- in a pretty good place on the assembly we think, really know, so you have everything. So it's components now.

Q - Serge Rotzer {BIO 4734915 <GO>}
Okay.

A - Benjamin Lu {BIO 15184293 <GO>}
Thanks, Serge. Thanks.

A - Bracken P. Darrell {BIO 3403495 <GO>}
Thank you, Serge.

A - Benjamin Lu {BIO 15184293 <GO>}
Our next question is from Tom from DA Davidson.

Q - Tom Forte {BIO 6796619 <GO>}
Great. Bracken, Nate and Ben congrats on an outstanding quarter. So two questions from me. The first one is, how should we think about the influence of the new gaming platforms for Sony and Xbox? And the gaming industry's ability to grow on top of the pandemic in general and Logitech, in particular?

A - Bracken P. Darrell {BIO 3403495 <GO>}
I apologize, I missed the first part of that comment because one of my personal assistant started to talk to me.

Q - Tom Forte {BIO 6796619 <GO>}
Sure, Bracken. How should we think about the new gaming platforms, Sony and Xbox and that enabling the gaming industry in general and Logitech, in particular, to generate

FINAL
Bloomberg Transcript

growth this year on top of the pandemic led sales in gaming?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah, I think the new gaming platforms from those two plus other companies are all drivers of long-term growth of gaming. And we're excited about cloud-based gaming, in general, and those two platforms -- and if you look at our ASTRO business it's done really well this year and we expect it to continue to do really, really well. This has been a banner. I mean an amazing period for the new consoles, and I think the new consoles are starting to spill over into PC gaming and there is an interaction between them. And I -- we're excited about that. I think the gaming business has never been more exciting. I don't see how that will end up

Q - Tom Forte {BIO 6796619 <GO>}

Excellent. And then my second question is, can you give us your current thoughts on the long-term opportunities for Logitech in virtual reality, especially in gaming?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah. So we've been working in virtual reality now for about four or five years, four years I think. We've had a dedicated team on it located at a couple of different places in the world. Our goal in that -- our goal there is really to try to be in the early stage of -- as augmented reality becomes more accessible for productivity, creativity and gaming, and -- but also in virtual reality. There is, obviously, in the virtual reality playing gaming. We've got a couple of things you can't talk about right now, but I think as that continues to grow, we're going to stay in the mix. We've got a product out now, that is not a gaming products, it's called Ink edition [ph], it's a stylus that you can draw and create in three dimensions.

We've got a couple of large companies using that to create -- design things, it's not a big product for us, but it's another opportunity for us to learn. I love the team we have on this. I hope they're listening. We've got super sophisticated people working on this both hardware and software.

And it's an exciting future. I can -- I may be in another call we'll talk about where the future will be one day, in offices and homes and how virtual reality -- and even more augmented reality we will be -- will probably be played there and we think we can really play a big role -- a bigger role there. So it's exciting.

Q - Tom Forte {BIO 6796619 <GO>}

Great. Thanks.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thank you.

A - Benjamin Lu {BIO 15184293 <GO>}

FINAL
Bloomberg Transcript

Our next question is coming from Andreas from ZKB.

Q - Andreas Mueller {BIO 16350975 <GO>}

Yes. Hello, (inaudible).

A - Bracken P. Darrell {BIO 3403495 <GO>}

Hi, Andreas.

Q - Andreas Mueller {BIO 16350975 <GO>}

Hi. First question, can you give a bit more color into the investments into IT and customer care infrastructure, which brought up also the G&A line, what is that exactly?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Nate, you want to take that one?

A - Nate Olmstead {BIO 21036514 <GO>}

Yes, Sure. I would say, as the business has grown, I mean our needs to support our customers have grown as well. And so we've just added scale and capacity into call centers and entered more enterprise-oriented support to support some of the VC growth that we've had. so those types of areas.

And on the IT side some of its projects that we had planned maybe over a longer-term, Andreas, that we simply have had the pull forward you know. Some of the scale of the company that we had planned for has pulled forward. We've had to increase the scale of some of the IT investments that we have to support that growth.

There is also some investments in G&A, as I mentioned in my prepared remarks that the -- that I expect will wind down by the end of this year. So I'm not expecting this level of G&A to be our new run rate, but it is one area where we've put some investment into it and I think very appropriately and that will remain. So a portion of what you saw in G&A is variable more probably for this year, and certainly, a portion of it's more fixed, still variable over the longer-term if volumes do not sustain at these levels. But we think it's certainly appropriate, given where we're at right now. And by the way, you still see G&A below 2% of sales. So I don't think it's something that you should have real concern over.

Q - Andreas Mueller {BIO 16350975 <GO>}

Okay, cool. When do you think you will see a normalization in the supply chain to be able to bring it down these logistics costs? I mean currently, probably it's still high, but what needs to be in place to bring them down these logistics costs?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah, it's true that our logistics and supply chains basically are air freight and express both have been super high. I think it will start to get a little bit this quarter, I don't know how

FINAL
Bloomberg Transcript

you feel, Nate, but I think maybe a little bit, and as we go into next year, we expect it to be more normalized.

A - Nate Olmstead {BIO 21036514 <GO>}

Yeah, I think that's true. I think I'll also say though that expedited freight is something that is a good option to have, and especially as you start to address more business users and large deployments and that may continue to be something that we want to utilize.

So I agree with Bracken, I think it will come down as supply catches up, again, in some of these categories, we've been chasing all year. But I also would say that it's an option that is available to us if we want to just kind of manage potential mismatches in the future between demand-supply, mix, volumes, some of these large deals, things like that.

Q - Andreas Mueller {BIO 16350975 <GO>}

Thank you. Good luck.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thank you, Andreas.

A - Benjamin Lu {BIO 15184293 <GO>}

Our next question is from Michael from Vontobel.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Hey, Michael?

Q - Michael Foeth

Yeah. Thank you. Hi, everybody. Two questions, actually from my side. First of all, on the use of cash, you already talked about your cash allocation strategy and you talked about organic opportunities. My question was here, should we expect you'd see R&D step up more materially going forward, and where would the priorities be in R&D? And along the same lines, your CapEx plans last quarter I think you announced an increase in your CapEx projections, question would be here if that guidance is still unchanged and where you're expecting to invest CapEx going forward? And then I have a follow-up.

A - Bracken P. Darrell {BIO 3403495 <GO>}

I'll pick that one, Nate. Yeah, I think -- yeah, we are increasing our investments in R&D and we'll keep increasing our investments. In terms of priorities, I wouldn't share too much for competitive reasons, but we're focused strongly in four broad areas and you can bet that they're all potentially hungry for investment that we should make and we will make. So we're going to really keep investing. Engineering has been the lifeblood of this company the long-term, design has unlocked the power of engineering. It's really always been about -- we have great engineering, we're going to keep investing there.

FINAL
Bloomberg Transcript

On the CapEx side, it's been an unusual year for CapEx because we've invested a lot more capacity than normal. It's still relatively low, I mean, I think we're at the very low end of what most companies our size would be doing from a CapEx standpoint. I don't know whether we'll need spend that much CapEx in the future. You want to add anything, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

No. I think that's right. Maybe just to be very precise, I mean we're guiding for $75 million to $80 million of CapEx spend this year, Michael, which, again as Bracken said, it's not a significant amount when you look at the cash we're generating, and I think the return on it is very strong.

In terms of R&D, just to put a lot more color on that, year-to-date R&D expenses, up 21%. So, I think we've been investing in it consistently this year, again, because that's more long-term oriented that does -- that is some more fixed cost, but again it's fixed costs addressing longer-term growth opportunities. So, very consistent with that.

The other thing within R&D and we mentioned this in the script, if you heard was, shifting resources between product categories. And so while it's 21% for the year growth or 23% for the quarter growth, within that we're reallocating resources. So some of the priorities that Bracken mentioned, are seeing growth well in excess of the 20% growth that you see at the company level, because of that reallocation internally.

Q - Michael Foeth

Okay, great. And then my second question would be in terms of your sustainability initiatives, two questions. What are your priorities going forward in fiscal '21 in terms of sustainability? And where do you think you are making the best progress currently?

A - Bracken P. Darrell {BIO 3403495 <GO>}

We are really, really excited over what we've done on sustainability. We have gone from -- we just got named on the Dow Jones Industrial Europe Sustainability Index. We are -- we signed up for the Paris Accord, and we're on track to deliver our first-year commitment against that. It's the 1.5 degree rise, trying to keep the globe to 1.5 degree rise in temperature. We've -- we announced this last quarter that we are going to be 50% of our mice and keyboards which is a lot of volume. We'll contain consumer recycle -- our recycled plastic and by the time we get to -- we have announced that publicly, but over the next year or two after that we'll get to 60% and 70% and higher.

We announced that we're going to be carbon labeling. We've got the first seven kind of product platforms done. Carbon labeling every single product in our portfolio and trying to encourage all of our competitors, and everyone in tech and beyond to do the same thing, so that we can try to get -- be part of the world that moves to making labeling carbon a little bit like labeling calories.

So once it's on the package some consumers will look at it and it will put pressure on all of us to try to bring that down. We've moved to renewable energy everywhere we can so far

FINAL
Bloomberg Transcript

we're aggressively going after that. We're investing in carbon offsets to offset whatever we can so far, and we're making big progress there.

So we have a big program going in sustainability. It's absolutely a value to the company and we're not going to let up.

Q - Michael Foeth

Okay, thanks a lot. Keep up the pace.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thank you.

Q - Michael Foeth

Thank you.

A - Nate Olmstead {BIO 21036514 <GO>}

Thanks, Michael.

Operator

Thank you, Michael. Our last question is from Reto from Research Partners.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Hi, Reto.

Q - Reto Huber {BIO 19785654 <GO>}

Yes, hello. Thank you for taking my question. I actually have two of them. First one, you already touched on it before, but I was wondering how much of your revenues were sold through your B2B channel in the quarter versus B2C? And how much is your addressable market going to change or increase as a result of your investments into the B2B channel? Is it simply going to double or is that wrong thinking?

And then my second or third question would be, how did the education order from Japan impact your gross margin in the quarter because I believe to remember that margins in education are below the Group's average gross margin, but maybe I'm wrong there?

A - Bracken P. Darrell {BIO 3403495 <GO>}

Yeah, that's true, both on the Japan or it is true that education is below our Group margin. On the other hand, it also is very -- it's a little lower OpEx so far by a long shot. So it's pretty efficient and profitable. I would say in terms of B2B as a share of the quarter, we don't really break that out. And your other question around the addressable market size increases. I think this is a good moment where I can invite you to our Analyst Investor Day, which will be coming up quite soon. We would love to have you join, and I think some of

FINAL
Bloomberg Transcript

those questions we'll be able to answer a little more clearly and rather than try to hustle through it at the end of an earnings call. I think it deserves more discussion on that. I do think, you're right, that our overall addressable market, our TAM this year has dramatically increased and we're excited about that. And the real question is, how do we unlock the power of that and I think that's the -- on the advertising front AID which will be sometime in the next several -- not too far away.

FINAL

Q - Reto Huber {BIO 19785654 <GO>}

Okay. Thank you.

A - Bracken P. Darrell {BIO 3403495 <GO>}

Thank you.

A - Nate Olmstead {BIO 21036514 <GO>}

Thanks, Reto.

A - Benjamin Lu {BIO 15184293 <GO>}

Thank you, everyone. And that concludes our Q&A session. I will turn it over to Bracken for his closing remarks.

A - Bracken P. Darrell {BIO 3403495 <GO>}

You know it was obviously a super-strong quarter. It's been a very strong year, but don't confuse that is temporary. I mean this is a long-term thing for us. We're completely committed. We're up -- most of the people in the company now are working on next year and the year after that, not this year. So it's been extremely exciting. You guys have been really great, challenging and collaborative investors and analysts partners for us all year long. We appreciate it, keep challenging us. I hope you will all come -- we haven't announced the date yet for our Analyst/Investor Day, but we will shortly and I hope all of you will join. We're excited about this year and we're really excited about next year. Thanks a lot. See you next quarter.

A - Benjamin Lu {BIO 15184293 <GO>}

Thank you.

Bloomberg Transcript

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the

views of Bloomberg LP. © COPYRIGHT 2021, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript