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Q2 2023 Earnings Call

Company Participants

- Bracken Darrell, President and Chief Executive Officer
- Nate Olmstead, Chief Financial Officer
- Nathan Melihercik, Global Head of Investor Relations
- Unidentified Speaker

Other Participants

- Adam Angelov
- Alex Duval
- Ananda Baruah
- Asiya Merchant
- Erik Woodring
- Joern Iffert
- Michael Foeth
- Paul Chung
- Rob Sanders
- Serge Rotzer

Presentation

Nathan Melihercik

Good morning and good afternoon. Thank you, everyone, for joining us. Welcome to Logitech's Video Call to discuss our Financial Results for the Second Quarter of Fiscal 2023. Joining us today are Bracken Darrell, our President and CEO; Nate Olmstead, our CFO.

During this call, we will 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're making these statements based on our views only as of today and our actual results could differ materially. We undertake no obligation to update or revise any of these statements, and we will also discuss Non-GAAP financial results. You can find a reconciliation of these Non-GAAP and GAAP results and information about our use of Non-GAAP measures and factors that could impact our financial results in our press release and in our filings with the SEC including our most annual -- most recent annual report and subsequent filings.

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These materials as well as our prepared remarks in slides and a webcast of this call are all available at the Investor Relations page of our website. We encourage you to review these materials carefully. Unless noted otherwise, comparisons between periods or 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. With that, I will now turn the call over to Bracken. Bracken?

Bracken Darrell {BIO 3403495 <GO>}

Thank you, Nate, and thanks to all of you as usual for joining us. Last quarter, we discussed the ongoing macroeconomic and geopolitical challenges impacting Logitech and the world. And the short story is that the industry is volatile. Inflation continues to be an issue, the dollar remains strong, the war continues and consumer confidence appears to be tepid. Despite this volatility, we're committed to a straightforward approach as we manage the business. We'll continue to invest in product innovation volume manage the near-term conservatively.

First, let's talk about innovation. We love the categories we're in. We're optimistic about the growth trends of the markets, the strategy, and our business model. We just had one of the most impressive sets of product launches in the history of Logitech. All told, we announced more than 20 new products in the quarter '20.

In my time at Logitech, I don't think we've ever launched this many. More important than this years number though, is that I believe this year, they have never been more innovative. We've increased our product development investments over the past three years, and you're seeing the results of those investments, as we further separate ourselves from others in the market.

And with everything going on in the world, our teams are doubling down. It's so exciting. Many of these new products by the way are additive to our existing portfolio. We're increasing our addressable markets, and equally as important, they're designed to take advantage of the big durable trends we've been highlighting. Video everywhere, hybrid work and the explosion of gaming into content creation.

We continue to develop products to help businesses and employees thrive in this new and evolving work from anywhere world. And as the environment changes, we're continuing to learn something new every day, every week about what the future holds. It's that evolution that creates the demand for innovation, and that's the kind of markets we like to be in. Markets where our expertise in design and user insights is rewarded by customers.

For example, for B2B customers, we announced Logitech site, address the question we hear most from the enterprise about video conferencing. What do I really need in a conference room to make hybrid work. We're passionate about creating an equitable experience for remote participants and in-room participants. Site is the next step bridging this GAAP. It's a tabletop camera. They'll be sold as part of our conference room solutions

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and it uses AI to more intelligently track conversations and provide a more natural video perspective to enhance meeting effectiveness.

I'm especially excited about this product because it highlights two important areas, where we continue to make strides. It's powered by AI software and excellent example of our increasingly software-driven solutions. And it's a perfect example of a product that's completely additive to our existing portfolio of conference room products, seamlessly working with Rally Bar -- just to name a couple of them. Nobody else has a solution like this, it's such an important product. I think it is the missing piece of the conference room setup.

For the Personal Workspace, we announced a new set of keyboards and mice designed especially for Mac users, which will expand our addressable market in the work-from-anywhere trend.

And now let's look at Gaming, where the team had a really strong quarter of product launches. Similar to the trend in Video and Hybrid Work, we're seeing more gamers demanding products that let them gain from anywhere.

We announced G-Cloud, a gaming device designed for cloud gamers that accesses PC and console games from nearly anywhere. And as the site for B2B customers, this product is completely additive to our gaming lineup. Gamers want on-demand access to their favorite games and high-quality gaming experiences, wherever they happen to be. And that's exactly what G-Cloud provides.

Later in the quarter, we released our lineup of PRO Racing wheels and pedals, which I believe are far and away the best in the industry. These are the high-end, high-performing products and the response has been incredibly positive, list goes on and on. Gaming launched its Aurora suite of products.

A new set of keyboards, mice, microphones and headsets targeting a larger customer set with expanded color and design choices and new features like headsets more easily worn with earrings and a broader range of hairstyles. For creators, we have a new studio-quality microphone and lighting. We're pushing ahead on the metaverse. And in partnership with meta, released an immersive audio solution, Logitech course. You get the point.

So what's the common thread that runs through these product launches? They offer a high-quality seamless experience for people to work, play and create, wherever and whenever they want. They're tightly integrated with our existing product portfolio, and in some cases, expand the addressable market.

By investing in our product roadmap, while also focusing on operational efficiency, we'll ultimately come out of this downturn, better positioned and poised for strong growth. Many companies talk about investing through times of economic uncertainty. We're doing it. But make no mistake, we're not operating in normal times and we are acutely aware of the macro challenges. We're focused on what we can control.

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Last quarter, we discussed a plan under this theme. What you saw this quarter of the first steps in executing that plan. We decreased our expenses focused on operational efficiency. We committed to reducing operating expenses by $150 million or 11% by the end of the fiscal year.

We're on track to meet that goal. For Q2, OpEx was down 15%. And part of the operational efficiency is realigning our org structure. Earlier this year, we merged our commercial organizations into one team. The goal was to serve B2B customers in a coordinated way, averaging one Logitech to sell a portfolio of Logitech's relevant products. This quarter, we evolved our business group and engineering structures to directly align with our new commercial structure and customer audiences.

B2B customers, end users, and gamers plus streamers, along with operational efficiencies, this will allow us to better compete within the enterprise market and better serve end users at the same time.

We executed targeted pricing increases, and our operations team continues to look for more cost-effective ways of getting our products to market. Our gross margin for the quarter was a strong 38.6% given inflation and currency headwinds, and we've not yet started to see the lower shipping rates flow through our P&L.

Looking ahead, you should expect us to continue to operate this way. We'll be prudent in the near term, while investing in our priorities to grow in the long term. And that's why I'm so optimistic about our future. People will invest in their workspaces, people will participate in video calls, people will gain, people will create content and Logitech will be right in the middle of all of it.

Before I turn the call over to Nate for a breakdown of our financial performance, I'd like to say a few things about what you saw in our press release about Nate's next steps.

Nate's been my CFO for nearly four years. We've worked through the pandemic, and have grown this company nearly twice the size of those when I hired him. He's done an amazing job as CFO in a period that's unlike anything Logitech's ever gone through.

Nate, and I talk regularly about his personal aspirations and those for the company. And over the course of these conversations, we came to an understanding that now would be a reasonable time for him to move on to the next opportunity. He's built a best-in-class finance team over the last few years that will support the transition for a new CFO. And as important, they planned to stay on Board and tells replacements in place. I am very grateful to you Nate, for everything you've done for Logitech and I can speak for the Board and so they are too.

So Nate, with that, can you take us through the quarter's financial performance?

Nate Olmstead {BIO 21036514 <GO>}

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Thanks Bracken, and thanks for your kind words. Let me walk you through the quarter in more detail. In Q2, net sales were down 7% to $1.15 billion. While sales were down, this was the third consecutive quarter of improved year-over-year growth performance. We grew in video collaboration and pointing devices, while gaming showed nice sequential improvement in year-over-year growth down 4% after being down 13% in Q1.

Gross margins decreased versus last quarter as expected to 38.6%, versus the prior year, product cost and freight rate increases were unfavorable 3 points, and currency was unfavorable 2 points. We partially offset these headwinds with our pricing actions and by driving down our use of air freight.

Operating profit was $156 million, reflecting lower demand inflationary cost pressures, and unfavorable currency, and our continued investment in our product development capabilities. Cash flow from operations was $73 million in Q2 and cash flow is up $215 million year-to-date versus last year.

Turning to results across our product categories. Gaming showed some resilience in the quarter, led by growth in Racing Wheels. For Q2, Gaming was down 4%, which is a marked improvement from last quarter. Americas and Europe Gaming sales remain pressured, while Asia continues to grow up 25%.

As with last quarter, we outperformed the market and gained PC Gaming share. We think our product portfolio is in great shape with strong new product introductions as we head into the holiday season. Video collaboration posted its second consecutive quarter of 7% growth, Video Conference Room Cameras and Peripherals grew nearly 30%. This growth was offset by a decline in business-oriented webcams, which were down more than 30% although their sales remained more than 3x higher than pre-pandemic levels.

We talked about this dynamic for several quarters. Pressure in webcams, following the incredible dynamic, a pandemic-driven growth somewhat offsetting solid and strong growth in conference room cameras and peripherals.

Pointing devices were up 3%, driven by our new lift ergonomic mouse and our high-end MX Master 3S. Keyboards and combos net sales declined 10% due to low-end market softness in China and Europe, partially offset by a strong start from our new high-end MX Mechanical keyboard. Keyboard sell-through was essentially flat in the quarter. And as with our business webcams, consumer webcams were pressured and down 33% from pandemic highs.

In any given quarter, results across our categories may not move up or down constant. It's the benefit of having a diversified portfolio that we like so much. This quarter was no different. So what we focus on is the performance of the categories that are addressing secular trends in gaming, video collaboration, and hybrid work.

Sales of our pointing devices, keyboards and combos, gaming and VC products were 80% of our total net sales this quarter. And we're up 1% year-over-year in constant

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currency and excluding Russia. Their sales grew 1% year-over-year in constant currency and excluding Russia.

It's also important to note that the combined gross margins for this set of categories are above the company average. So, our biggest categories addressing attractive secular trends grew and produced above average margins.

Turning to expenses. Consistent with the first quarter, we reduced our expenses, most notably in sales and marketing, which was down 21%. As Bracken mentioned earlier, we remain committed to investing in product design and development to strengthen our category leadership, and we increased R&D spend by 3%. Last quarter, we committed to reduce our annual operating expenses by $150 million versus last year, and we are on track to meet that commitment by year end.

We will continue to focus on finding efficiencies throughout the organization as we align our spend with our sales. We ended the quarter with a cash balance of $869 million. In September, our shareholders approved our proposed dividend distribution, which when combined with our continued buyback program returned $276 million to shareholders in the quarter.

We are now halfway through the fiscal year, and despite the headwinds, we remained confident in our ability to meet the outlook we announced last quarter. As a reminder, that outlook calls for full year revenue in FY '23 to be down 4% to 8% in constant currency. The U.S. dollar continued to strengthen versus last quarter. And currency now projects to be a roughly 5 point headwind to U.S. dollar growth. Therefore, our outlook for full year revenue and U.S. dollars would be down 9% to 13%.

Our full year non-GAAP operating income outlook remains between $650 million and $750 million despite the incremental currency pressures. This pressure is expected to be offset by incremental efficiency gains throughout the organization and favorability in Logistics rates.

Much like last quarter, our intent is to provide you with a range of reasonable outcomes, given the highly volatile nature of the global economy. We've made assumptions about a number of factors, including potentially protracted economic volatility, and sustained revenue and profit pressure from the stronger U.S. dollar.

At the high end of our outlook, we assume a relatively normal holiday cycle, while at the low end, we've assumed a holiday lift generally aligned would be worst in the last decade. And while it continues to be challenging to forecast with a level of precision and certainty in line with pre-pandemic business cycles, we believe maintaining our forecast is prudent and reasonable.

The other Nate, it's time to open the call for your questions. Thanks.

Questions And Answers

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A - Nathan Melihercik

(Question And Answer)

All right. Great. Thanks, Bracken. Thank you, Nate, for those --

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you. And thank you, Nate.

A - Nathan Melihercik

For those interested in asking a question, please raise your virtual hand. We'll start today's Q&A with Asiya Merchant from Citi. Asiya, good morning.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Asiya.

Q - Asiya Merchant {BIO 20247269 <GO>}

How are you guys? Good morning, and surprised and sad to see you leave, Nate. Best of luck. And thank you for always sharing your insights and providing clarity on callbacks, et cetera.

So a couple of questions that I've gotten as the release came out. The macro conditions remain volatile, and I know you guys talked about seasonality in the back half of this year. Can you give us any anecdotal evidence or qualitatively, how you guys are thinking about the back half of this year, especially in terms of the holiday season and calendar 1Q which is your which is your fiscal 4Q?

And then another question on inventory, if I may. I think that declined, if my numbers are correct, that declined sequentially ahead of a holiday season. If you can walk us through what were some of the dynamics there. That would be great. Thank you.

A - Bracken Darrell {BIO 3403495 <GO>}

Yes. Nate, why don't you take both of those? I think Nate talked a little about the first one, and the second we can cover quickly.

A - Nate Olmstead {BIO 21036514 <GO>}

Sure. Yes. So I think [ph] as far as the back half of the year, Asiya, like I said, the outlook really represents kind of two ends or two -- multiple scenarios, which you can think about it. I guess at the high end, it's a pretty normal holiday lift that we would see. And then on the low end, we've assumed something that really aligns with kind of the worst sequential growth that we've seen over the last decade. So we're thinking about it in kind of two ways. I think some of the -- normally in the holiday, right, you'll see very strong performance from some of the consumer products. And so maybe those will be a little bit more muted because consumer confidence has been a little bit weaker, but you saw the

performance in video collaboration, again this quarter grew 7%. And we're excited about some of the opportunities for us in B2B.

So, really thinking about it across the spectrum. We've got a very diversified portfolio. So that's kind of how I would answer your first question. I guess, on the second question, yes, it came down sequentially. We did build up some inventory because of all the supply constraints that have been out there, the logistics disruptions. Some of those are starting to alleviate. We're starting to see some better performance from Logistics providers, as well as reduced costs that we think will benefit us in the second half of the year. And so we'll be working down that inventory. We'll do it prudently, but it should come down further in fact in Q3.

A - Bracken Darrell {BIO 3403495 <GO>}
Yes. I'll just add to that. We expected, Asiya, to bring inventory down in this quarter, even though it was going into our holiday quarter and we did. So it's -- we're pretty much right on track.

A - Nate Olmstead {BIO 21036514 <GO>}
Right.

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

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

A - Nathan Melihercik
Thanks, Asiya. Next question, we will go to Paul Chung, J.P. Morgan.

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

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

Q - Paul Chung {BIO 21176642 <GO>}
Hi. Thanks for taking my questions. And Nate, you will be missed, very nice working with you.

A - Nate Olmstead {BIO 21036514 <GO>}
Thanks you.

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Q - Paul Chung {BIO 21176642 <GO>}

First up, on OpEx flexibility, providing some cushion here on your operating profit outlook. Which areas are you cutting back? Are there any trade-offs on revenues as a result? And you mentioned some Board structure changes, et cetera. And should we expect kind of a bounce back in OpEx when kind of top line comes back or continued focus on efficiency here in the near term?

A - Bracken Darrell {BIO 3403495 <GO>}

Let me jump in first, Nate. Then you can --

A - Nate Olmstead {BIO 21036514 <GO>}

Sure.

A - Unidentified Speaker

-- answer.

A - Bracken Darrell {BIO 3403495 <GO>}

Overall -- maybe I'll answer what are we not cutting back. We're actually growing our product development investment as you know. We're pulling back in different areas throughout the business including marketing, where as Nate talked about, (inaudible) pulled back pretty significantly. Really on that top of the funnel marketing that we feel like at the end of the day, when the markets are generally softer, top of the funnel marketing is not as effective, whereas search engine optimization, things you'd expect us to keep investing in, we'll certainly keep investing in. So that's really the kind of the headline. Go ahead, Nate.

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. Obviously, agree with all that. Paul, if you recall, we talked in the past about, as we were investing more and as the revenue growth was very strong in FY '21 and even in FY '22, we were conscious of the fact that we wanted to be investing in a variable way if possible and where it made sense. And so that has helped us as we've had to reduce expenses or we've taken action to reduce expenses here in the first half. And -- so you're seeing some of the benefits of that strategy in the execution that we talked about before.

I think even when you look at our marketing spend though, we're really aligning it with sales. And if you look back, historically, we're kind of at levels right now that are consistent with level of investment we had there before. So we haven't cut back, as Bracken said, on all marketing, but we're just being very thoughtful about where it makes sense to invest now. And I think if conditions change and we start to see more revenue growth and gross profit expansion, you may see us increase those investments again.

Q - Paul Chung {BIO 21176642 <GO>}

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Got you. And then just to follow up. Can you talk about the cadence of product releases, I think you mentioned 20 or so. And then kind of your commitment to R&D, which is doubled since '19 levels. Where are you kind of seeing relative strength from new product lines, like the (inaudible) and G Cloud, Mac line of keyboards. And what products are kind of resonating the most with customers? Thanks.

A - Bracken Darrell {BIO 3403495 <GO>}

Yes, let me -- first of all, in terms of the cadence, we usually do launch quite a few products in Q2 ahead of Q3. And this was really a record. I mean, I think, I don't know. We can try to go back and count, but we announced 20 new products this quarter. I mentioned that in the call. So I am super excited about we're doing -- our innovation engine is just sort of firing on all cylinders.

The other cool thing about it is a lot of those products are in completely new markets. I mentioned that in the script, new addressable markets, things like G Cloud, Logi side. And yes, what I'm excited about, that's a good example. I mean I think this -- the ability to -- I think anybody who's been in a video call lately and been one of the remote participants has had some nice stand with their back to the camera, they feel really out of it. And this really answers that.

And the cool thing about it is, you need our existing products to use it. And so you have to -- and you don't have to wait to buy them, you can buy them now and then this will just be a complement when it comes out. So it's a really cool product. I'm excited about the Mac line of products we have. We already had a very high-end MX Master and MX Keys version. Now this brings into a lower price point. So everybody can afford to really have an alternative to Apple's experience, which is great.

And I could probably keep going. G Cloud can be really interesting to see how it does. I think you're going to -- just keep an eye on that category. Netflix started one day and now look at it. I think these cloud gaming -- these cloud gaming services are going to be really big over time. And we're the first one. That was really a mobile experience add-on. [ph] So it's super exciting across the board.

Q - Paul Chung {BIO 21176642 <GO>}

Great. Thanks.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you.

A - Nathan Melihercik

Next question will be from Alex Duval, Goldman Sachs. Hey Alex?

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Alex.

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Q - Alex Duval {BIO 16682293 <GO>}

Hi, everyone. And thanks so much, to Nate, for the conversations over the years. A couple of quick ones. Firstly, you saw a 7% decline organically constant currency in the quarter. So I wondered if you could just help us understand a bit more about how you get to minus 6% at the midpoint for the full year. To what extent is the story of comp effects or product launches? How should we be thinking about that? And secondly, related to this, if you look at video conferencing, you referenced the back to office dynamic. Just wondered to what extent we should think about that benefiting you from a few more quarters? How are you thinking about that as well? Thank you.

A - Bracken Darrell {BIO 3403495 <GO>}

Why don't I take the last one, Nate. I think we're seeing at the very beginning of really the re-enablement of an office. I think there's a lot of -- there's -- one of the most common questions -- I talk to a lot of CEOs and CIOs, there's -- one of the most common questions is, gosh, how is this going to work long term? I mean we're an interesting example. We're -- we've redone an office -- one big office we have in Switzerland. We just changed offices in Cork. So we're just moving into it. We're changing offices next year in Silicon Valley, all caused or at least accelerated by what's happened during the pandemic with hybrid work becoming the way we work.

So I think we're pretty representative maybe a little bit on the front of the curve of most companies. So I think most companies over the next few years are all going to be adjusting size structure inside the office, the whole thing. And that really bodes well for us because then you really got to rethink, how many rooms we're going to have, how many rooms are going to have video, how many workspaces do I need? I'm sure they're going to upgrade those. They're going to change the structure inside. And the people at home, they really now do need better, better stuff. And like I said, on many calls, everybody on this call can upgrade their workspace, I guarantee, there's so many (inaudible) I'll tell you exactly what you should do.

So it's a really -- I think it's a very good-looking future for us in the whole B2B space, whether it's B2B, in the office or B2B at home.

A - Nate Olmstead {BIO 21036514 <GO>}

And then on your question around the guidance, Alex, yes, I think you kind of hit some of it in your question. The compares are much different to the first half and the second half. In the first half of last year, we grew 24% in constant currency and in the second half of last year, we declined 9% in constant currency. So it's a pretty big difference in the year-over-year compare half to half. And so we think that this full year outlook is reasonable.

Q - Alex Duval {BIO 16682293 <GO>}

Thank you very much.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you.

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A - Nathan Melihercik

Thanks, Alex. Next question will be from Adam Angelo, Bank of America. Hey, Adam.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Adam.

A - Nate Olmstead {BIO 21036514 <GO>}

Hey, Adam.

Q - Adam Angelov {BIO 22341766 <GO>}

Hey. How is it going? Thanks for having me on. So firstly, on the gross margins and the 3 percentage points of inflation headwinds you mentioned. Just wondering is there any reason as these things probably ease further over the next few quarters, why you wouldn't see the benefit. So you mentioned shipping is not really coming through the P&L yet. Is there any long-term contracts there on the component side, on the shipping side that would prevent you seeing the benefit?

And then secondly, just on G Cloud, kind of curious to see like more strategically, kind of teased it a little bit there, but more strategically, is this a move into more of the center of gaming and away from peripherals? Just anything you could kind of give on that. Thanks so much.

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A - Bracken Darrell {BIO 3403495 <GO>}

Yes, I'll answer the last one first, Nate, and then you can jump into the first one. The answer is we've been systematically expanding categories for 10 years. So this is another category expansion. As you said, you could argue it's more into the, as you call it, the center of Gaming, although needless to say, I'm the CEO of Logitech. So I think our products really are the center of gaming. They're the last things you touched, the central things, they're involved in gaming. [ph]

But we're going to keep expanding categories. We think there are opportunities not only in gaming, but across the board. And several of the products we launched this time, as I said earlier, were really new addressable market opportunities for us. So yes, I'm pretty optimistic about that.

A - Nate Olmstead {BIO 21036514 <GO>}

In terms of the cost, Adam, up in cost of goods sold. I mean that's one of the reasons why I wanted to call that out is I want to give you visibility of what some of the drivers are of the margin. And in the case of cost, you kind of got two big buckets, you've got logistics and then logistics cost and product cost. Those will begin to flow through as benefits in the second half, but you have to remember, we have to work down inventory before we start to see some of those benefits. Some of it is contracts that we have, although we're able to buy on the spot rate in some cases as well.

So I do believe logistics will probably see some of that benefit a little bit earlier. And then as we get into next year, probably see more of that favorability start to flow through the P&L. Of course, you always got to keep in mind that we may decide to take pricing actions going in the other direction. There's a lot of moving pieces to it. But net-net, I would expect some of those cost pressures to start to become tailwinds as we move into the back half of this year and then more so into FY '24.

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A - Bracken Darrell {BIO 3403495 <GO>}

But I will say, and if you listen carefully to Nate's script, that's 5 points of headwind. We still have delivered almost 39 points of gross margin with 5 points of headwinds between currency and cost. And as you're suggesting, Adam, neither one of those is likely to last forever. The cost is certainly at a high and currency is incredible high. So I certainly wouldn't make any commitments about the next 12 months, a year or something. But long term, that's -- I'm really excited about that. And I think the fact that we could deliver 39 points of gross margin with 5 points of headwinds that are pretty temporal and some time frame is exciting.

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. I mean I think that's exactly the right point, Adam, is there's a lot of earnings power here, right? We're getting more efficient on our costs. Obviously, an uncertain and volatile time right now from a macro standpoint, but our gross margins remain strong. And you can see what some of the headwinds are there. And so we have to make some assumptions about how long it's going to take for some of those cost pressures to reverse, but there's some strong margin power in this model.

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Q - Adam Angelov {BIO 22341766 <GO>}

Great. Thank you.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you, Adam.

A - Nathan Melihercik

Our next question will be from Joern Iffert from UBS.

Q - Joern Iffert {BIO 15374623 <GO>}

Hi. Thanks for taking my questions. The first one I would be, please, on your APAC operations. Quite important success factor in the quarter. Where is this growth exactly coming from? Is it category growth? Is it share gains? Is it new regions? If you can put some light on this would be quite helpful. And the second question would be, please, Bracken, you mentioned this, there are a couple of changes in the organization in the B2B, go-to-market strategy and also in business group and engineering. Can you give us more details what exactly you are doing here? Thanks a lot.

A - Bracken Darrell {BIO 3403495 <GO>}

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Yes, absolutely. We did kind of shorthand, I guess. Nate, I'll take the last one. You take the first one. Yes. So what are we doing? What are we talking about? So this set of changes really started at the end of last fiscal year, at the beginning of this one, and we quietly put two sales forces together. Why did we do that? Because we really wanted to bring all of Logitech to B2B customers as one. So now we've got one organization bringing -- one commercial organization, bringing all of Logitech, whether it's a personal workspace or a room.

The reason we did that was because I think I mentioned this in the last call, as we were aggressively selling in video conferencing equipment, we were increasingly having people say, "Oh, and before you leave, could you please -- can we talk about mice and keyboards? And so we were underdeveloped in the B2B market in our whole personal workspace or as we call it B2B, personal workspace, mice and keyboards and things. So by changing that commercial alignment, we have now one message to the customer, one idea of what is Logitech and one thing we can talk about.

That was the first step. The second -- this last round of changes, we didn't change the business group structure to adapt to that. That was part of the driver here. So we have 1 B2B organization that interfaces directly with that group. So it's a kind of a pituser and a catcher now. So we've got one team, and this should make us much stronger on our overall B2B business.

We did a couple of other things on top of that. We centralized our software engineering for most of the business now and our hardware engineering for the first time. That's more efficient. But the more important thing is, I think it's going to give us the ability to move step by step further and further into services and software-enabled services and also to leverage the fact that we have all the hardware sitting on one desk, all the names of people buying things, all the data that's coming in and the ability to get our products to work and do more things together.

So I am really, really excited about the set of changes. It's a big new chapter for Logitech.

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. And Jorn, to answer your question about APAC region. Normally, we talk a lot about China there. China actually didn't have a strong quarter as it had recently, but that was more than offset by really good performance in Australia and Korea. So just like a lot of places, we're diversified even within region. And the strength that we saw other than gaming, which we saw really good performance across the region, I would say. But in Korea and Australia, it's really kind of across the portfolio, the mice, keyboard, video collaboration, all had very, very strong quarters.

Q - Joern Iffert {BIO 15374623 <GO>}

And may I ask why? Why was Australia and Korea was so strong in the quarter?

A - Nate Olmstead {BIO 21036514 <GO>}

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Well, again, I think countries -- you got to look at prior year compares. And I think the way that the world has been evolving has been different by country, right? The pandemic had different timing in different places and reopenings and transitions back into retail and so forth. So there's really just a number of factors. I mean I think we saw the market was a little bit strong in some of those areas. We had some share gains. A number of factors. But the portfolio, I think with the new product introductions that we talked about on this call, I think we're seeing some of the benefits of that. And those are investments that we kicked off and have been increasing over the last several years.

Q - Joern Iffert {BIO 15374623 <GO>}

Thanks a lot.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you, Joern.

A - Nathan Melihercik

Great. Our next question will be from Rob Sanders at Deutsche Bank. Hey, Rob.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Rob.

Q - Rob Sanders {BIO 19087450 <GO>}

Yes. I just had a question regarding the upcoming selling season. I was just wondering what's your priority? Is it preserve profitability, maybe hold on to elevated inventory? Or will you look to clear the channel? I mean, I noticed you haven't been too active on the promotional front so far, but I was wondering if that might change. And I have a follow-up. Thanks.

A - Bracken Darrell {BIO 3403495 <GO>}

Yes, I'll jump in on that, Nate. I wouldn't be surprised if it's a little more promotional in Q3 than -- just because Q3 is always a little more promotional. And so it wouldn't be too surprising. But I think our real priority is we've got great innovation. So I feel super about the product lineup we have and the portfolio we have going into the Q3 and Q4 and beyond. So our -- the holiday season and beyond that. So I think our priorities are not going to change too much. It's -- we've really got what we need to sell and now we need to go sell it. Do you want to add anything to that, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

No.

Q - Rob Sanders {BIO 19087450 <GO>}

I just had a -- thanks for that. I just had a quick follow-up. Just if you could just remind us. I know you've taken a lot of share post previous downturns because a lot of companies

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have kind of exited, et cetera. I was just wondering like, historically, when have you taken the most share? Is it basically as those companies kind of flame out because they start losing money? Or is it you look to kind of press your advantage and press the brand even at this stage? Thanks.

A - Bracken Darrell {BIO 3403495 <GO>}

I think I'd characterize our share gains a little differently. I think we've gained share because we've really innovated and we focused on brand building. If you look at what we've done inside of our gaming business, we've just consistently gained share every year. It wasn't -- didn't have much to do with -- honestly, didn't have too much to do with competition. It was about us. We really innovated well and built a brand and built relationships with gamers and influencers and brought that to market.

If you look at our -- if you go to Google search -- Google search trends and type in Logitech G and just look over the last 10 years, and you'll see how much -- how long that's been headed up and to the right. And by the way, that's haloed all of Logitech, too. So it's gone beyond that. So I think generally -- and it's really not been about competitors flaming out or something. Very few competitors have left our business. It's really about us performing.

A - Nate Olmstead {BIO 21036514 <GO>}

Yes, Rob, I just want to echo that. We've been talking for a while about moving from push to pull, right, and making investments in marketing, reducing reliance on promotion. And that's not something you just turn on in one quarter. That's a long-term journey. And we accelerated that through the strength of our results during the pandemic and increased our investments. And I mean, I think that what you're seeing and what you have seen consistently over the last several quarters has been benefits of those investments and decisions we made.

A - Bracken Darrell {BIO 3403495 <GO>}

Exactly. Absolutely, great point. If we do say so ourselves, we put ourselves on the back.

A - Nathan Melihercik

Thanks, Rob. Our next question is from Erik Woodring at Morgan Stanley. 'Morning, Erik.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Erik. How are you?

Q - Erik Woodring {BIO 19492555 <GO>}

Good morning, guys. Thank you. Thank you for taking the question. Nate, you will be sadly missed. I will give a shameless plug to someone that maybe used to work for you that might be on -- might be looking for a CFO job. No. But it --

A - Bracken Darrell {BIO 3403495 <GO>}

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He seems to have a fan club out there.

Q - Erik Woodring {BIO 19492555 <GO>}

In all seriousness, Nate, thanks for all of your help. Maybe I'll direct two at you. One was just getting back to your comments on gross margins. Because if you look historically, sequentially, you see pressure in the December quarter, owning to the fact that it is a bit of a more promotional period. But then you talked about some of these more temporal headwinds, inflation, logistics. And so I'm just wondering if there's any reason why that type of seasonality this quarter shouldn't exist? Or any -- maybe if you could walk us through some of the puts and takes to at least help us think about gross margins for December? And then I have a follow-up.

A - Bracken Darrell {BIO 3403495 <GO>}

I know that was for Nate, but I have to jump in, Erik. First, while those headwinds are temporal, they're not that temporal. Hopefully, you'll see a huge change in Q3.

Q - Erik Woodring {BIO 19492555 <GO>}

Okay.

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. My outlook really doesn't assume much change in gross margins from current levels, Erik. There's a lot of factors why Q3 gross margins might be up or down. Category mix is another one intended historically -- you were talking historically. Historically, mobile speakers was a much bigger part of our portfolio. It's now 2%. And that was one of our lower-margin categories when it was scaled. And so you did have some mix impacts as you went into the consumer period, as well as like you said, a little bit more promotion for Black Friday and those types of big events.

I think as our business portfolio has shifted towards a little bit more of the business customers, that mix effect will lessen a little bit. But yes, typically, I would still expect margins to come down a little bit in Q3. But there's lots of big factors at play here in the back half, as Bracken mentioned. And he's absolutely right. We are not assuming a big significant swing in costs and seeing that favorability to flow through. I do believe that, that will happen, but we're not predicting that to be super significant here in the second half.

A - Bracken Darrell {BIO 3403495 <GO>}

And I would add. I do think it will be -- somebody asked a question earlier, I think it will be a little more promotional in Q3 just because we always are. And I think that's just the reality of the world we're in right now, too.

Q - Erik Woodring {BIO 19492555 <GO>}

And then maybe just as a follow-up. Year-to-date, I guess, your cash flow from operations is tracking below operating income. The guide is for those to eventually converge by year end. Maybe just talk about some of the factors that give you confidence in the cash flow

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recovery in the back half of the year. Is that largely inventory? Or is there anything else that you would call out as a driver of that improvement? And then that's it for me. Thanks, guys.

A - Nate Olmstead {BIO 21036514 <GO>}

Got it. Yes, I think inventory, working capital, in general, will be one of the big drivers. That's -- basically, your cash flow is going to be two big components. It's going to be your profit and your working capital. I think in the back half of the year, you'll see some efficiency improvement in working capital.

The quarter was a little bit back-end loaded as customers were -- a lot of our large customers were adjusting inventory levels early in the quarter. They started to repurchase again in the back half. So our collections was -- we didn't finish all the collections of all the sales this quarter, so we'll see some benefit from that in Q3. Aging is great on AR, no problems there, just a little back-end loaded, and so we'll see higher collections in Q3.

Okay. Thanks, Erik.

A - Bracken Darrell {BIO 3403495 <GO>}

Thanks, Erik.

A - Nathan Melihercik

Our next question will be from Serge Rotzer, Credit Suisse. Hey, Serge.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Serge.

A - Nate Olmstead {BIO 21036514 <GO>}

Hey, Serge.

Q - Serge Rotzer {BIO 4734915 <GO>}

Yes. Good morning, gentlemen. First question, I have two or three. You mentioned that you launched 20 new products. And I'm wondering, will these new products be margin accretive, no impact or dilutive? And secondly, even more important, what's about the availability now? Are these products already in the shelf for Q3? Or is this something for next fiscal year?

A - Bracken Darrell {BIO 3403495 <GO>}

Yes. So first of all, I would say, with 20 products, probably on average, they're margin -- they are neutral -- margin neutral. But we've got some that are accretive and a few that are dilutive. Generally, they're available. We've got a few that are coming later. Logitech sight is going to come later. We announced it early because we -- it really is complementary. You could buy a room system and then get it all set up, have it ready to

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go, get used to it and then bring this in and drop it right into the middle of the table, literally. And it will improve the overall experience. So that's an example when that's not available. On the other hand, other things like G-Cloud are available now.

So it's kind of a mixed bag. But generally, everything is available.

Q - Serge Rotzer {BIO 4734915 <GO>}

Sorry to take again G Cloud. Is it available only in the U.S. (inaudible)? And in big volumes or only available, let's say -- or let's say dilutive or accretive to the gaming margin, because you mentioned that gaming margin is increasing?

A - Bracken Darrell {BIO 3403495 <GO>}

Yes, we're going to keep it pretty limited because -- in limited production rate to start. We try to do that with brand new categories, and then we can always turn this -- pick it on if we need to.

A - Nate Olmstead {BIO 21036514 <GO>}

Okay. Hey, Serge, one thing I need to -- you asked about margin, but also keep in mind, the ASPs and things like site is -- relative to the rest of our portfolio, it's a high ASP product. PRO Racing wheels are high ASP product. G Cloud is a high ASP product. So it's not universal across the board, but you're seeing, again. It's not like we just flip the switch on this stuff. We've been working on these things for a while. There's a lot of software content in there, a lot of value. So I feel very good about that.

Q - Serge Rotzer {BIO 4734915 <GO>}

No, that's a good point. Probably a year on the guidance, you increased the currency impact from 4% to minus 5%. And you said reported sales will be lower or decrease is higher, but you left EBIT unchanged. So basically, it's a guidance upgrade. Is this true? Do you see it as the guidance upgrade? And what's the main factor for this guidance upgrade if you'd like so?

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. I called out two things, briefly, in my prepared remarks, additional efficiencies that we're finding across the organization. So that could be in OpEx. It could also be in COGS. Keep in mind, we've got $3 billion plus of spend up in our cost of goods sold. So there's a big pool of spend there for me to look for efficiency with the teams. And then also, we do think we're starting to see some of those spot rates on logistics come down, especially on the ocean. And so as we get into the back half -- really into the back half of the second half of the year into Q4, we'll probably see some favorability from that, that will help offset the currency pressure.

Q - Serge Rotzer {BIO 4734915 <GO>}

Okay. It's a basket. Thanks. So -- and then the last one, restructuring charge minus $11 million; and other income, minus $25 million. Is this all related to the new organization? Or

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can you give us some flavor here? And should we expect this to continue in the next quarters?

A - Nate Olmstead {BIO 21036514 <GO>}

The restructuring is related to the org changes Bracken went through. The other item was a write-down of an investment that we had on our books from years ago, Lifesize, if you remember, was a company that we used to own that we spun out, and we wrote down the value of that this quarter.

A - Bracken Darrell {BIO 3403495 <GO>}

Noncash.

A - Nate Olmstead {BIO 21036514 <GO>}

Noncash, yes.

Q - Serge Rotzer {BIO 4734915 <GO>}

Okay. Got it. Many thanks.

A - Bracken Darrell {BIO 3403495 <GO>}

Thanks, Serge.

A - Nathan Melihercik

Great. Our next question is from Michael Foeth at Vontobel. Hey, Michael.

A - Bracken Darrell {BIO 3403495 <GO>}

Hello, Michael.

A - Nate Olmstead {BIO 21036514 <GO>}

Michael, hi.

Q - Michael Foeth

Thanks for taking my question. And thanks, Nate, also for all the conversations. Just one left for me on pricing strategy. You said you've taken some pricing actions in the quarter already. Two questions there is -- one is how much leeway do you have with pricing given that consumers, especially in Europe are already quite squeezed. So what's your view on that? And then how much did those pricing actions actually offset the other sort of headwinds that you had on gross margin?

A - Bracken Darrell {BIO 3403495 <GO>}

I'll let Nate answer the second, but I'll answer the first one. How much leeway do we have? I think that remains to be seen. I think we've raised prices a couple times in the last year, and they weren't really small price increases either. The last round, I would say, was

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really a response to the continued currency challenges, and we focused it in Europe and Japan, a couple of other places. And I think it remains to be seen. I think it's -- we feel pretty good about it on the high end, on our more higher-end products.

On the low end, it's going to be competitive, and we're not going to give up any share on the low end. So we'll make sure to stay competitive there. So we may moderate a little bit on the low end if we have to, but we're holding the line for now. We haven't seen competitors follow in most cases actually in the second round. So we always raise and then wait. And if we have to, we play hardball.

A - Nate Olmstead {BIO 21036514 <GO>}

And then the second part of your question, Michael. I mentioned we had 5 points of headwinds. I mentioned those. Gross margins were down less than 5 points year-over-year. We've got about 1 point of benefit year-over-year from pricing thus far to help offset some of those cost pressures in currency.

Q - Michael Foeth

Okay. Thanks, guys. Well done. Thank you.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you, Michael.

A - Nate Olmstead {BIO 21036514 <GO>}

Thank you.

A - Bracken Darrell {BIO 3403495 <GO>}

And there is Ananda.

A - Nathan Melihercik

Ananda Baruah from Loop. Good morning.

A - Nate Olmstead {BIO 21036514 <GO>}

Hey, Ananda.

(Multiple Speakers)

Q - Ananda Baruah {BIO 15320341 <GO>}

Hey, how's it going?

A - Bracken Darrell {BIO 3403495 <GO>}

(inaudible) down the street from all of you in New York or around New York today. I'm here in the New York.

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Q - Ananda Baruah {BIO 15320341 <GO>}

Is that right? Is that right? All right. Well, let's -- we'll get coffee about 45 minutes after this call ends, Bracken.

A - Bracken Darrell {BIO 3403495 <GO>}

Okay.

Q - Ananda Baruah {BIO 15320341 <GO>}

You just gave up the (inaudible). You should have hit me -- yes, well, you should have hit me before the call, you're really good at (inaudible). Listen, thanks for the question. I appreciate it. Nate, we'll miss you man. Really enjoyed the conversations. Hopefully, we can continue them in a different context. So different context, different setting. So I look forward to the call back.

A - Bracken Darrell {BIO 3403495 <GO>}

We're not letting him go just yet. So --

A - Nate Olmstead {BIO 21036514 <GO>}

I will be here for a --

Q - Ananda Baruah {BIO 15320341 <GO>}

100%. Understood. I guess my question is, what's the -- how would you guys context like the visibility to the guidance maintenance relative to sort of normally, it feels like we're still kind of like at the front end of macro, making like a commercial impact, impact on commercial spend. And certainly, it seems like we're -- we'd probably not -- we're probably still in the first half of the game of interest rate increases and things like that. So I guess I'll sort of leave the question there, but would love to get how you guys relate to sort of the conviction in the guidance maintenance.

A - Bracken Darrell {BIO 3403495 <GO>}

If I could jump in first, Nate. I think we have a relatively wide range on the guidance, right? And I think Nate -- when Nate introduced, he talked about the range of outcomes. So I think this is -- reflects the fact that there isn't a person on this call who can accurately predict what's going to happen over the next two quarters. So -- but within a range, we feel pretty good. Do you want to add to that, Nate?

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. And I'd just come back to diversification, Ananda. I think it's really important. In times of uncertainty, diversification is really your friend. And I call -- I mentioned those big four categories, 80% of the sales actually grew a little bit, excluding currency in Russia. And so that's -- it's very important. I think the -- yes, so I'd probably just say that. I think diversification really helps. And as Bracken said, we've given a range.

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Q - Ananda Baruah {BIO 15320341 <GO>}

Now -- let me look, it's helpful. It makes -- I totally get maintaining. I mean you guys hit the -- you hit the quarter, and it sounds like it's tracking to expectations right now. So that all makes sense. And can you remind us, Nate, what was -- sort of when you lowered the guide previously, what were the main drivers of that adjustment?

A - Nate Olmstead {BIO 21036514 <GO>}

Yes. Two things. And one was currency. We had not pushed through all of the impact of currency until last quarter. And then the other was really just the increased volatility and what looked to be a sustained volatility in the macro climate and the number of factors that we have to keep an eye on. So I think it was really those two things. I think all the way back to March, beginning of the year at AID, [ph] I think the war had just begun. And so -- there was a lot of uncertainty about what would happen there. And obviously, unfortunately, that has persisted. So.

Q - Ananda Baruah {BIO 15320341 <GO>}

Yes. I actually think you did your Analyst Day like 10 days before it started, something like that.

A - Bracken Darrell {BIO 3403495 <GO>}

Something like that.

Q - Ananda Baruah {BIO 15320341 <GO>}

Something like that. Cool. That's it for me, guys. I appreciate it. I'll get you -- listen, Bracken. Bracken, I'll see you at your coffee shops, I'll see you --

A - Bracken Darrell {BIO 3403495 <GO>}

I'm here for any of you in New York in -- until year end, I'm here. I'm ready for coffee, and what's --

Q - Ananda Baruah {BIO 15320341 <GO>}

Let's do it.

A - Bracken Darrell {BIO 3403495 <GO>}

All right.

Q - Ananda Baruah {BIO 15320341 <GO>}

Let's do it.

A - Nathan Melihercik

Thanks, Ananda.

A - Bracken Darrell {BIO 3403495 <GO>}

Thank you, all.

A - Nathan Melihercik

Okay. Bracken and Nate, that looks to be a wrap on questions for this morning.

A - Bracken Darrell {BIO 3403495 <GO>}

All right. Well, thanks, everyone, and we'll see you next quarter.

A - Nate Olmstead {BIO 21036514 <GO>}

Thanks a lot. Bye now.

A - Bracken Darrell {BIO 3403495 <GO>}

See you there.

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