

REFINITIV STREETEVENTS

EDITED TRANSCRIPT

LOGN.S - Q3 2024 Logitech International SA Earnings Call

EVENT DATE/TIME: JANUARY 23, 2024 / 1:30PM GMT

CORPORATE PARTICIPANTS

Charles D. Boynton *Logitech International S.A. - CFO*

Johanna W. Faber *Logitech International S.A. - CEO*

Nate Melihercik

CONFERENCE CALL PARTICIPANTS

Ananda Prosad Baruah *Loop Capital Markets LLC, Research Division - MD*

Andreas Müller *Zürcher Kantonalbank, Research Division - Research Analyst*

Asiya Merchant *Citigroup Inc., Research Division - VP & Analyst*

Dong Wang *Barclays Bank PLC, Research Division - Research Analyst*

Erik William Richard Woodring *Morgan Stanley, Research Division - Research Associate*

Jörn Iffert *UBS Investment Bank, Research Division - Director & Analyst*

Jürgen Wagner *Stifel Europe, Research Division - Director*

Martin Jungfleisch *BNP Paribas Exane, Research Division - Research Analyst*

Michael Foeth *Vontobel Holding AG - Head of Swiss Industrial Research*

Samik Chatterjee *JPMorgan Chase & Co, Research Division - Analyst*

Torsten Sauter *Kepler Cheuvreux, Research Division - Head of Swiss Equity Research*

PRESENTATION

Nate Melihercik

Good morning, and good afternoon. Welcome to Logitech's video call to discuss our financial results for the Third Quarter of Fiscal Year 2024. Joining us today are Hanneke Faber, our CEO; and Chuck Boynton, 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. Our actual results could differ materially. We undertake no obligation to update or revise any of these statements. We will also discuss our non-GAAP financial results, and you can find a reconciliation between GAAP and non-GAAP results and information about our use of non-GAAP measures and factors that could impact our financial results and forward-looking statements in our press release and in our filings with the SEC. These materials as well as the shareholder letter 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 are year-over-year and in constant currency and net sales. This call is being recorded and will be available for a replay on our website. I'll now turn the call over to Hanneke. Hanneke?

Johanna W. Faber - *Logitech International S.A. - CEO*

Thank you, Nate, and welcome, everyone. I'm very excited to be here today for my first earnings call at Logitech. Now you've probably noticed that this quarter, we introduced a new document as part of our earnings material, a shareholder letter. This letter is intended to be a comprehensive review of our quarterly results and includes commentary that previously would have been covered at the beginning of the call. So today, after brief opening remarks, we will move directly into Q&A.

Now let's move on to this quarter. Our team delivered really solid results in the third quarter, and I am proud of the product innovation, the share gains, the operational discipline and the prudent financial management throughout the quarter, resulting in really healthy gross margins and exceptional cash flow generation.

Our disciplined execution, tightly managing costs and promotional spend drove a 22% increase in our operating margin. That is tremendous work by all of our teams but we will not be satisfied, of course, until we return to top line growth, which will be a gradual process. As we look forward, I am delighted with Logitech's positioning.

Our portfolio is designed to take advantage of indisputable trends in hybrid work, video conferencing, gaming and content creation. And disruptive technologies like AI will provide additional opportunities for us. As we work our way back to growth, we have demonstrated consistent, disciplined operational excellence that builds a highly cash-generative P&L and a very strong balance sheet.

This discipline, coupled with an innovation engine that introduces new products at a global scale, drives our market leadership across multiple categories. I've spent the last 2 months visiting with our employees, partners, customers and shareholders. It's been a really exciting time for me, and I am as optimistic about Logitech's future as when I joined on day one.

We will be hosting an Analyst and Investor Day later this spring, and I'll provide you with a more detailed perspective on our strategy and our approach to capital allocation then. Additionally, we will then provide our outlook for fiscal year 2025. I really look forward to seeing you all at that event. Thanks again. And let me turn it to Chuck to discuss the numbers. Chuck?

Charles D. Boynton - Logitech International S.A. - CFO

Thank you, Hanneke. Thank you all for joining us on the call today. You've seen our detailed financial results in the press release and shareholder letter, but I'd like to highlight 3 metrics this quarter that really stand out.

First, our gross margins of 42.3% were better than expected year-over-year due to lower product and logistics costs, reduced promotional activities, specifically in North America.

Second, we've spoken for several quarters about our focus on driving lean operations. For the seventh consecutive quarter, we reduced on-hand inventory. And this quarter, it was down 44% year-over-year with our inventory turns hitting 6.5%.

And finally, in Q3, we delivered \$443 million of operating cash flow, one of our best ever. This was driven by an improvement in the cash conversion cycle and strong operating margins.

We are updating our outlook for the full year. We are now expecting revenues of \$4.2 billion to \$4.25 billion, up from \$4 billion to \$4.15 billion. Our operating income is expected to be between \$610 million and \$660 million, up from \$525 million to \$575 million. One final note regarding fiscal year 2025. If you look at our last 4 quarters as well as the midpoint of our fiscal '24 outlook, you will see the declines in our net sales have moderated.

Looking ahead to fiscal '25, we do not anticipate an inflection point in the slope of this curve while the rate of our net sales declines has improved, there are a number of headwinds and uncertainties that may impact our net sales throughout fiscal '25. Thank you to all of our employees for the hard work and impressive execution. With that, Nate, let's move on to Q&A.

QUESTIONS AND ANSWERS

Nate Melihcick

(Operator Instructions) And with that, we'll start with Samik Chatterjee at JPMorgan.

Samik Chatterjee - JPMorgan Chase & Co, Research Division - Analyst

And congrats on the robust results here. Maybe just to -- Chuck, just to start with your ending comment there about the headwinds you're thinking of for fiscal '25. Maybe just flesh that out a bit more for us in terms of -- I mean, obviously, if there's been any improvement in the pace of declines or you moderate those declines, but why shouldn't this close sort of carry you back into growth? What are the headwinds you're thinking of? And I have a quick follow-up.

Charles D. Boynton - Logitech International S.A. - CFO

Yes. That's a really good question. We thought very hard about what next year is going to look like. And if you look at the fundamentals of our business, they're very strong right now. We feel really good about the execution. If you look at this last quarter in Q3, a lot of it was driven by really strong discipline on pricing and promotional activity.

The baseline business in Q3 outside of the promotional windows was a little softer than what we would have thought. The promotional windows were incredibly strong with great pricing discipline, but the overall pace of the run rate business was a little soft. And if you look forward into Q4, the midpoint of our outlook for the year would indicate a 1% decline in Q4.

Now the high end of our outlook would imply a little bit of growth in Q4. If you look into next year, there's just so much uncertainty around -- will there be rate cuts in the U.S.? The macro situation globally, whether it's in China or Middle East or Europe? And so we're taking a cautious approach to next year.

And as we look out, we're confident this is a great business, profitable, strong margins. As Hanneke said in her comment it makes sense. It's if not when. But if you just look at the overall market, we just think that we don't want to be -- have people get too optimistic about what next year is going to look like given these overall headwinds in the geopolitical situation.

Samik Chatterjee - JPMorgan Chase & Co, Research Division - Analyst

And Hanneke, if I can. I know it's early days in your role, but as you sort of looked at across the customer base, particularly if you look at them as enterprise versus consumer, and you think about the sort of next couple of years, where do you see the bigger opportunities? Where are we more likely to return to growth in which customer segment faster than the other? Just share your thoughts on that, please?

Johanna W. Faber - Logitech International S.A. - CEO

Yes, sure. And it's nice to meet you, Samik. I see opportunities everywhere when it comes to our customer base. So we're really, really strong in retail. And you saw that over the holiday period, just great execution in store after store whether it was here in the U.S. or in Europe or in Asia. We also have grown online a lot with our e-retail customers. And then, of course, there's B2B.

And we're newer to the B2B business, but the opportunity there is gargantuan. So many meeting rooms that are not yet enabled with video. And as that corporate spending comes back, I think we're really well positioned with products that are fantastic, easy-to-use, great value for that B2B segment. So opportunity everywhere. B2B is a little newer to us, but I'm quite bullish on that.

Nate Melihercik

Our next question is from George Wang at Barclays.

Dong Wang - Barclays Bank PLC, Research Division - Research Analyst

Just 2 quick ones. Firstly, can you talk about kind of gross margin. The December quarter was strong and any thought on kind of outlook going forward in 4Q and FY '25. And then kind of as it relates to sort of a long-term model of 39% to 44%, just curious kind of any thoughts on kind of modeling for the margin going forward.

Charles D. Boynton - Logitech International S.A. - CFO

Yes. Thank you, George. No change to our long-term model. We believe the 39% to 44% is the right range. This past quarter was stronger than we had expected, 42.3% gross margins, we had expected somewhere in the 38% to 39%. So we were really pleasantly surprised at the results for the quarter. The real drivers, if you look overall, kind of year-over-year, it was roughly in line.

If you look at it -- or sorry, quarter-over-quarter is roughly in line. Year-over-year, we saw pretty good margin expansion. And that's really driven by a couple of factors. One, we did a great job on the operations side, getting product costs down. Logistics costs certainly benefited all the industry participants with lower shipping and freight costs. And that was the big primary driver. And then, of course, the great execution, primarily in Americas on pricing and promotions led to about 100 basis point improvement. So I'd call it overall about 400 basis points benefit on product and shipping costs, lower promotional spend led to higher margins and offset a little bit by mix that we had forecasted.

Dong Wang - Barclays Bank PLC, Research Division - Research Analyst

Got it. Yes. Just a quick follow-up, if I can. I just want to double-click on the gaming seems very strong, kind of being better than expected for the last couple of quarters. Just maybe you can give more color just on the gaming peripherals. And kind of maybe if you can pass out within gaming kind of for any particular areas are doing a little bit better, mice keyboards, gaming headsets, what not. Just because the gaming traditionally kind of showed us in the refresh cycle versus other PC-related peripherals. So maybe you are seeing kind of all the COVID cohorts that started refreshing maybe could potentially drive the results higher. Just curious if you can kind of double click on the gaming category.

Charles D. Boynton - Logitech International S.A. - CFO

Yes, certainly. I can go first, Hanneke. So the gaming, as you know, covers many different categories. We saw particular strength in simulation in our steering wheels, a really, really good quarter. Overall go-to-market was impressive, how we promoted and discounted.

If you contrast that to a year ago, the teams were very disciplined in what products they promoted and which channels. As Hanneke mentioned, retail was really, really strong. That led to better margins and better revenue. The PC segment, we have a really, really strong position with mice and keyboards in that PC segment, we gained some share.

Console was a little bit off that we have a new product out that's really, really exciting. The A50 that was released kind of just at the end of the holiday. So we didn't quite see the sales on the console side. It's a very, very competitive category. But we feel like the future looks bright in Console, although it is very competitive. But the areas that we generate higher margins mice and simulation, incredibly strong. Other parts, maybe not quite as strong, but will help on the way with new products. Anything you want to add Hanneke?

Johanna W. Faber - Logitech International S.A. - CEO

No. I think long term, again, I'm super optimistic about gaming as a big growing category. It used to be focused on pretty narrow audiences, younger male but that continues to explode with more females gaming with older people gaming with gaming as a way to connect socially. So category where all the macros are in favor and then with our strong execution and our strong innovation, I think we look really good in that space.

Nate Melihercik

Our next question is from Asiya Merchant at Citi.

Asiya Merchant - *Citigroup Inc., Research Division - VP & Analyst*

If you could just dial into a little bit on the growth stuff. I understand there are macro headwinds, but it seems like on the PC side, things have turned around a little bit. We're starting to see some recovery. Maybe you can talk us through on the -- maybe you feel a little bit better about the PC peripherals. And what would it take to kind of get back into your kind of target model that was laid out at the analyst event last time? Both in terms of gross margins as well as the top line growth.

Charles D. Boynton - *Logitech International S.A. - CFO*

Yes. Asiya. So if you think about the long-term model, I'll talk long term first. So we have a target long-term financial model of 8% to 10% growth. One key tenet in there is M&A. We've been light on M&A the last couple of years. And I would expect us to do more over the next couple of years, not right away, but I would expect us to do more over the next couple of years. And that will be an important part of getting back to that 8% to 10% growth.

Another key tenet of our ability to return to growth and get to higher levels of growth is rationalization of the corporate office footprint. If you look at what's happened in the headlines this past quarter, North American vacancies have approached 20%. And so corporates are still looking at their overall real estate footprint and how they want to outfit rooms.

The TAM is enormous, the installed base is relatively small. There will be an upgrade cycle of that installed base to new modern tech like ours, and there will be greenfield deployments that will grow. So if you look out 10 years, it makes perfect sense that every conference room will be video enabled. It's just hard to say what's going to happen over 1 year or 2 years. So I think this is another thing like Hanneke mentioned, if not when. It's unclear what that deployment cycle will look like.

And then lastly, on the B2B side, companies like ours are looking at their IT budgets, carefully controlling things like CapEx and spend, they're prioritizing things like AI and cybersecurity absolutely employee productivity and office room fit-outs are going to happen, but they're more discretionary IT spend versus mandatory and so I think the economy needs to improve a little bit, potential rate cuts, maybe more confidence in the future on the corporate side.

The Consumer though right now is quite strong. And so I think overall, I feel really good about our positioning. But overall, enterprise, B2B office rationalization and then to hit the longer-term rates, a little bit of M&A sprinkled in there as well.

Asiya Merchant - *Citigroup Inc., Research Division - VP & Analyst*

And then when you think about gross margins also in that target range, I know you guys are obviously at 40%, feel really good about that, just if you could talk a little bit about getting to kind of even the midpoint of your gross margins of the 39% to 44%.

Charles D. Boynton - *Logitech International S.A. - CFO*

Well, we were really close to that midpoint this past quarter at 42.3%. So I feel really good about this quarter and last quarter. We did have a couple of one-timers this quarter. So if you look overall at the impressive inventory reductions that we achieved. We drove down inventory more than \$80 million decrease quarter-over-quarter in inventory.

When inventories come down, good things happen. And we saw that again this quarter with things like [E&O] releases because effectively, as you reduce inventory, you have to reserve less inventory. And so we saw benefits there that will not recur. We don't expect inventories to come down. They could actually grow a little bit in Q4 with the Suez Canal challenges.

But overall, if you look at where we think margins will be in Q4, it's our trough quarter, so there's less overhead absorption. So it's a little bit of a headwind on a quarter-over-quarter compare. And then we also have this additional freight challenges. So I think overall, we'll have maybe the low end of that target range in Q4.

And I would expect it to be in that overall operating model on average over next year. Will it be at the high end? It's possible, low end is possible. So I think a lot of it will just depend on how next year unfolds from a consumer sentiment standpoint and enterprise demand standpoint.

Nate Melihercik

Our next question is from Erik Woodring at Morgan Stanley.

Erik William Richard Woodring - Morgan Stanley, Research Division - Research Associate

Hanneke nice to see you for the first time. Looking forward to working with you. Maybe if we start, Chuck, I'm going to pick on gross margins again, just because they were so impressive. And I guess maybe my question is -- last quarter, we had talked about them being in the 38% to 39% range.

You obviously did more than 42%. So I guess where -- was there something that outperformed your expectations that you didn't necessarily foresee 90 days ago? I'm just trying to pick on that because I would think that generally, when it comes to component costs, you kind of have a lock on that 90 days ahead of the quarter.

And so I'm just trying to understand where the biggest delta was between your expectations and how you actually materially outperformed? And if I could weave in, as we look to the fiscal fourth quarter, we have historically generally seen gross margin expansion despite the loss of revenue leverage, less promotions, a little bit more B2B mix than consumer mix.

And so why should we think about gross margins coming down so much sequentially? Maybe I'll start with that and then I have a follow-up.

Charles D. Boynton - Logitech International S.A. - CFO

Yes, Erik. Really, really good question. So first of all, this past -- in the last few quarters, we brought our inventory down significantly. When you bring this inventory number down, you release reserves. So there are some benefits that we've seen quarter-over-quarter, the last couple of quarters, quite frankly, on bringing inventory levels down.

Those are kind of more onetime in nature. What is durable? The great work that our operations team has done to reduce product costs. That has been a real, real benefit overall to the company and that is durable. That we'll see those benefits throughout next year.

So I thank our team, Prakash and his team did such a great job on product costs, Shipping and Logistics, that was a real tailwind, better than we had expected. Now that's reversing. So you look at what's happening now with shipping rates. They're going back up again, fairly material on the ocean. We also expect because of these disruptions to have to do more air.

And while we don't want to, we don't want stock outs, we have a customer-first mentality. The first thing is take care of the customer. So we will eat some margin to take care of customer satisfaction. So air shipping, higher ocean rates. That's just a reality of where things are right now from a shipping standpoint. Is that transitory? Is that going to last throughout the year? I can't predict but that is a headwind going into our Q4.

And then the overall leverage that you mentioned, that's just straight math. And if you have a peak quarter to trough quarter, there is an impact. If you look at the impact, you said last year, you saw margin expansion. That was primarily because of a fairly poor Q3 last year. So that was a -- I think that we over discounted and drove less volume in Q3 a year ago.

And our global commercial teams just really executed so well this past quarter in pricing discipline. And Erik, we had talked about that on the last few calls, we were set up with our retailers and e-tailers. We had really gone through the promotional plans and the account planning and our teams on the ground just landed such a great quarter from a promotional standpoint.

So I think that 38% to 40% gross margin, if you do the math and you deduct what is the range for Q4, it's roughly 38% to 40%. Midpoint to high end is doable at the low end, it'd be more air shipping. So I think we're set up for a really strong fiscal Q4. But these uncertainties on the freight and logistics side are what gives us kind of pause at this point in time.

Erik William Richard Woodring - Morgan Stanley, Research Division - Research Associate

Okay. Very fair. Chuck. And then I don't know if this is properly posed to you or to Hanneke, but you bought back more stock this quarter than I think any quarter over the last 10 years. You also reduced CapEx relative to your prior expectations. So are you guys maybe signaling a change in your capital allocation priorities? And why not as you're kind of striving to get back to growth, realize the macro is a big factor here.

But maybe why not utilize the excess cash you generate to lean into CapEx and whether that's more product launches or better expansion or whatever it might be, but why not kind of lean into that CapEx to maybe help get you back to that kind of target growth range a little easier, faster. However, you might think about it? And that's it for me.

Charles D. Boynton - Logitech International S.A. - CFO

Yes. That's a really good question there. I'll talk in a little more detail Hanneke, and maybe you want to talk about our capital allocation strategy at a higher level.

First of all, on CapEx, I would not read into that. CapEx itself at this point is down, but don't read into that. That's just operating discipline. We are very, very focused on driving efficiency and spend. We will invest for growth. Growth is our top priority, is how we invest in our capital allocation model.

And then overall, if you think of the buybacks, we set -- in the beginning of the quarter, we saw the cash numbers improving, getting better and better and better. And so what we did is we decided to increase the buyback given how great of a cash quarter we had. We generated \$443 million of operating cash flow, one of our best quarters ever. And when we saw that data coming in, we decided to increase the buybacks to return more capital to shareholders. But don't read into the CapEx spending because it will go back up next year.

We have done very little M&A. We have invested heavily in the business. We definitely will invest and prioritize investments in technology to drive long-term growth. So don't read into the CapEx reduction as being a -- we're pulling back. We are focused on driving growth. It's really more operational discipline. Hanneke, do you want to talk about the high-level capital allocation strategy?

Johanna W. Faber - Logitech International S.A. - CEO

Yes, sure. And let me first just confirm what you just said. I mean, we will make the right CapEx investments into the future. And we're looking at those for next year right now. So don't take this as we're pulling back on CapEx. In terms of our long-term capital allocation strategy, that really hasn't changed at the top of the list paying a good dividend. Number two, M&A when the right thing comes along, we are definitely always looking and then only number three, returning cash to shareholders in the form of buybacks.

Nate Melihercik

Our next question is from Jürgen Wagner at Stifel.

Jürgen Wagner - *Stifel Europe, Research Division - Director*

Yes. Hanneke, my first question would be to you now that you are 60 days at Logitech. Can you say or can you share already some thoughts, what needs to be addressed or what you need to do differently? And as a follow-up, you mentioned M&A as the second priority. When would you be in a position to become more active again?

Johanna W. Faber - *Logitech International S.A. - CEO*

Yes. Yes, Jürgen, thank you. Very nice to meet you. I'm 60 days in. So it's a little early to say anything about anything. And so I'll say upfront, we have an Investor Day planned for May where we'll come out with much more detail. But I'll give you a few first impressions. This is a really good company, would be my top line impression.

We're really well positioned for future growth with the spaces that the portfolio is in. So hybrid work, gaming and video conferencing, all are good places, good neighborhoods to play in. Then we have fantastic and I've been so impressed as I've onboarded with our product, our engineering and our design capabilities.

That allows us to innovate, and that will allow us to win going forward. Another few things that I've been impressed with is the brand, a really solid global brand. But that also brings me to an opportunity. We probably have an opportunity to make that brand truly iconic take it from good to great, if you will.

And then finally, a nice mix of B2B and B2C. We touched on that earlier. And the last thing would be this company really is a sustainability pioneer in tech, which is great to see and something we'll definitely -- we'll want to continue to be.

So I would say all of those things we'll want to keep and cherish and leverage to drive growth going forward. There probably are a few things I would change as well, but it may be too early to talk about those right now. And when it comes to M&A, again, details much too early, but an important part of our capital allocation strategy.

Nate Melihercik

Our next question is from Ananda Baruah at Loop.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Hanneke, welcome to the conversation. Yes. So I guess just real quick on the -- Chuck, on the long-term growth model. You mentioned, I think you said high single digits. I guess the question -- and you mentioned M&A as being a meaningful contributor to that. So I guess the question is, is that high single digits organic? Can you talk to that yet over time? Or is that high single digits with the M&A and sort of in the organic [TBD.] And then I have a quick follow up.

Charles D. Boynton - *Logitech International S.A. - CFO*

Yes Ananda. Yes, really yes, thank you. That -- the 8% to 10% is -- basically that number is derived from the historical growth rates pre-pandemic. Obviously, the pandemic if you -- it's 70-ish percent growth. So you got to kind of take those years out. But that's really the average growth rate

for the 10 years pre-pandemic. Some years, it was 4%, some years it was 14%, but it averaged in that 8% to 10% range. That included, importantly, many key acquisitions. We're very good at M&A. We find the right companies.

We exploit that technology. And if you look at what we're great at, we have these global distribution channels at scale. So we can go buy companies, plug them into our network and exploit that technology. We have an operations team that can drive product costs down and do a really good job. And as Hanneke mentioned, this iconic brand. So I think we have this great machine that can plug companies in.

So the 8% to 10% is accounts M&A, that's part of the formula for sure. But there's nothing planned in the short-term horizon. Hanneke is brand new. We're working on the strategy. So I wouldn't expect any big announcements anytime soon. But it's an important part of the long-term growth rate, nor are we predicted to get back to that rate anytime soon. This is a long-term financial model. The part that we are executing on today is the gross margins of 39% to 44%, keeping OpEx at roughly 25% and generating a very healthy operating income.

That is right now, that's today, we feel very good about that. A couple of quarters ago, we said that was 6 or 8 quarters out, we're very excited about executing on that part of the long-term financial model today. But overall, growth is the focus. We just want to be cautious going into next year, and then we'll talk at Analyst Day more about the model and our thoughts on M&A and whatnot. But yes, 8 to 10 is not organic. It's organic plus M&A and M&A is a key part of that.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Got it. That sounds super helpful. And I have just a clarification quickly, and then I have a quick follow-up question. When you say next year, we're talking fiscal '25 -- [so really not] calendar '24.

Charles D. Boynton - *Logitech International S.A. - CFO*

Fiscal. Yes, fiscal '25 starting April 1 of next year, that's right -- or this year. I'm sorry. Yes.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Got it. And you guys had mentioned in the prepared remarks, I think it may have been Hanneke who mentioned this, AI as an opportunity for the company. Any context you can give there? And I guess really what I'm wondering is, are there things that sort of you would consider to be incrementally new to the company in terms of value add for market share opportunities, new categories, which you could go in that you're thinking about that sort of behind closed doors it classically fit into the ecosystem of products that the company has historically offered?

Johanna W. Faber - *Logitech International S.A. - CEO*

Yes, I'm happy to take that because it's one of the other areas where I see a lot of opportunity. Really 2 ways that we're leveraging AI at Logitech today. One, of course, is internally on productivity, like every other company and that's table stakes, but it's well underway here. Whether that's in supply chain and marketing, using CoPilot, ChatGPT and our own large language models. So that's well underway.

The area I'm more excited about is in our products and in our innovation. And again, there's -- I'll mention 3 things that I'm excited about and that are already out there, but they're -- they can tell you a little bit about what's to come as well. So on the video conferencing side of the business, we have a new product out called Sight, which is a panoramic video conferencing camera that you sit right in the middle of your conferencing table. That one is like having a TV producer in your meeting and you get perfectly framed, your audio is perfect, your video is perfect. So I love that. And that leverage is AI to get that done. So that's on the video conferencing.

Then on headsets, the zone to wireless headsets just out again, also leverages AI technology. And here, the consumer insight is, and I hate this myself, you're talking to someone you have a headset on, that other person is at an airport or is outside and there's a ton of ambient noise on the other side, leveraging AI, this new headset canceled ambient noise on both sides, which is super cool. So really great product.

So those are 2 product examples. The last one is on our software. So if you have any of our products, whether it's a mouse or a keyboard you can download the software that goes with that, one of the features is called smart actions where you automate some of your repetitive tasks. What we've seen in the last 4 or 5 months is that, by far, the #1 repetitive tasks that our users are simplifying is something called Reply with ChatGPT, 9 times as much as any other smart action. So again, it shows how we can help both through our hardware and our software, delight consumers more with AI. Sorry, it's a bit of a lengthy answer, but I'm excited about the opportunities for innovation that we can leverage in our products and the growth we could get from that.

Ananda Prosad Baruah - *Loop Capital Markets LLC, Research Division - MD*

Yes. No, that's helpful. And so that taking the 3 you just mentioned right there, like to me, that would be more suggestive of potential market share gain opportunities or product stickiness opportunities, something along those lines.

Johanna W. Faber - *Logitech International S.A. - CEO*

Spot on.

Nate Melihercik

Our next question is from Jörn Iffert at ABS.

Jörn Iffert - *UBS Investment Bank, Research Division - Director & Analyst*

Nice to meet you Hanneke. And the first one would be, please, to you, Hanneke. May I quickly ask you, when you look over the next 3 to 5 years, do you think the categories and the segments Logitech has right now is the right place to be to drive your growth vision? Or are you also willing to go into new end markets like, for example, healthcare, which could be necessary to maintain the growth model going forward?

Johanna W. Faber - *Logitech International S.A. - CEO*

I think we're playing in with some really great spaces. So the big space of work and play that's what people do in life. So we play in some gargantuan spaces, and they give us good growth. Within that, are there verticals we could step on a little harder? Possibly, and that's what we're exploring in our strategy work right now. So a bit early for me to say yes or no, but we'll be back on that in May.

Jörn Iffert - *UBS Investment Bank, Research Division - Director & Analyst*

Yes, sure. I appreciate this. And then the second question, a little more technical one on the quarter, please. You were mentioning that outside the promotion season, which was Black Friday, Cyber Monday, volumes were a little bit short of your expectations. Is this linked to macro and market weakness? Or is this linked to the market share losses? I think you also mentioned a couple of market share losses. Also gains, of course, but also some share losses like gaming keyboards for example, China and other stuff. So is it also linked to share losses or mainly macro?

Charles D. Boynton - Logitech International S.A. - CFO

Yes. I think generally, I would characterize the quarter from a share standpoint as a strength and not a weakness. So on balance, we executed well. And I think when the dust settles and the final reporting comes in, it's not all finally in yet, we need to see all the final data coming in. I think it will show on balance. We gained share across key categories. The categories where we may have had some challenges where we had older products and NPIs or new product introductions are on the way.

So I feel on the share side, pretty good. I think, overall, the consumer as it was a year ago, was looking to buy on promotion. And the run rate business globally was more challenged outside of the promotional windows. And we're seeing that so far in the first few weeks of this quarter. So I don't -- it's hard to say is that interest rates, is that consumer confidence is okay right now, is it enterprise spending.

I think it's kind of a little of the above. I think there's just a little bit of uncertainty out there. And that gives us a little bit of caution going into Q4 and into next year on when will that return? I think there's news about sticky inflation and maybe rates won't get cut there's a lot of macro factors that we read in the news every day.

And I think that translates into our customers buying our products and other companies' products. But I don't -- I would not say it's a share issue. I think our share is strong and it's doing quite well across the board outside of some key pockets that we're addressing. Anything, Hanneke, you'd like to add there?

Johanna W. Faber - Logitech International S.A. - CEO

I think you said it well.

Nate Melihercik

Our next question is from Andreas Müller at ZKB.

Andreas Müller - Zürcher Kantonalbank, Research Division - Research Analyst

Hanneke, good to see you both. Can you discuss maybe the gap between sell-in and sell-through, particularly in the Americas? Is this seasonal? Or do you see your clients already increasing inventories sustainably there?

Charles D. Boynton - Logitech International S.A. - CFO

Andreas. The chart you're referring to in our earnings deck shows sell-through and sell-in. And I'll just say, I don't like that chart in general. We've agreed to keep it through this year, and we'll revise it to make it more meaningful at Analyst Day. That data shows that America sell-through was down 4%, yet we saw fairly strong revenue growth actually.

And so you look at that and say, "Gee, how can sell-through be down but sell-in go up. Oh, you must have built channel inventory. We did not actually. Americas channel inventory was roughly flat. What's driving that is less promotional activity or selling at a higher price and promoting less. So the sell-through is in gross dollars and the revenue is in net dollars, and that's just -- that delta of 700 basis points is the margin expansion based on less promotional activity and efficient promo activity.

So we're going to revise that chart to give you a little more view into kind of the changes in channel inventory, which is, I think, the better metric. So I wouldn't read into that too much. It's kind of comparing apples and oranges a little bit. But we didn't want to pull it.

I started just less than a year ago. I didn't want to pull that chart without replacing it with something to give you better visibility. So there will be an update to that coming in May, I -- but I would not read into that overall other than saying we did a great job on driving North American promo activity during the holiday period.

Andreas Müller - Zürcher Kantonalbank, Research Division - Research Analyst

Okay. And then my next question on the gross margin progress, the lower product costs were mentioned. Can you give here some more details? I mean you mentioned production efficiency, but also I mean, what was the impact of raw materials, for example, Asian currency were weak, which might have helped. Can you say something here?

Charles D. Boynton - Logitech International S.A. - CFO

Certainly. I missed the very first part. Was it gross margin in Q4?

Andreas Müller - Zürcher Kantonalbank, Research Division - Research Analyst

On -- Yes. And on the production side or on the products.

Charles D. Boynton - Logitech International S.A. - CFO

Yes. So we had about 200 basis points of benefit year-over-year on product costs. Quarter-over-quarter, it was roughly in line a year ago to this year, about 200 basis points of expansion, that should be durable and should translate into future quarters as well. 200 basis points year-over-year was logistics, ocean, air, freight. And then there were some other kind of noise between lower promo and mix.

But overall, the freight side is going to come back. We're going to have more freight headwinds in Q4. That will be a challenge. And then on the FX side, year-over-year to Q3, it was about 100 basis point benefit. As you look into Q4 to Q4 and Q3 to Q4, currently, FX is roughly flat.

So there will be -- there should be no currency impact. Of course, rates can change. But as we sit here today and you look at the euro and the pound and the various currencies around the world, on balance year-over-year and quarter-over-quarter, were roughly in line from Q3 to Q4.

Andreas Müller - Zürcher Kantonalbank, Research Division - Research Analyst

Okay. Then my last question, can you say something about the OpEx items, R&D and G&A here? And do you expect that progression going forward? In G&A, how much was the impact or was the increase actually onetime in nature?

Charles D. Boynton - Logitech International S.A. - CFO

Certainly. So our OpEx model is fairly straightforward. We want to spend roughly 25% of our revenue on OpEx. Of course, in OpEx, we want to prioritize things like engineering, product development, go-to market, those are things that build health and build value long term. Then you have things like G&A and other costs that are necessary but you want to be efficient on the spend. So that's the overall model as a whole. Now if you look overall, the details of what happened in the quarter, we had CEO transition costs that basically were onetime in nature.

And then we have really overperformed this year financially. And a year ago, we were underperforming. So as a result, things like sales commissions and variable compensation a year ago were unfunded or funded at a much lower level. This year, we're funding above plan given the above-plan performance. And so I wouldn't expect the overperformance on variable comp to continue so much. So there are some one-timers.

But overall, if you look at where OpEx as a percent of revenue, obviously, in our peak quarter, it looks very impressive. But our model really is 25% approximately of revenue, and it will be a little higher likely in Q4 because it's our trough revenue quarter. So we're saying, on average, it's that 25% range. But we -- I feel really good about where this year is shaping up from an investment standpoint. And again, prioritize investments on those things that grow shareholder value.

Nate Melihercik

Our next question is from Torsten Sauter at Kepler.

Torsten Sauter - *Kepler Cheuvreux, Research Division - Head of Swiss Equity Research*

Well, congratulations to another strong quarter. In fact, it feels like in the good old days, right? Just with a few new faces. Very glad to meet you, Hanneke, and very happy to work with you.

Johanna W. Faber - *Logitech International S.A. - CEO*

Thank you.

Nate Melihercik

Actually, I have 2 little questions, if I may. Firstly, a more technical one. I see you have again cut the tax guidance to a very, very low level.

Can you please shed some light on that? And also maybe try to give an outlook there.

Charles D. Boynton - *Logitech International S.A. - CFO*

Certainly. Yes.

Torsten Sauter - *Kepler Cheuvreux, Research Division - Head of Swiss Equity Research*

Yes. If I may, just to have it said already, we've seen the departure of your Design Head, Alastair Curtis, I think I had considered him a key person, right? So maybe can you guide us to the strategy with respect to running the design, operation to design team at Logitech going forward?

Charles D. Boynton - *Logitech International S.A. - CFO*

Certainly, I'll take the first one and you can take the second one. On the tax side, we had reached agreement with the [Canton of Vaud,] where we're headquartered this past quarter to increase the basis of the business overall, that allows for a larger amortization and a tax deduction. And this is because we have significantly grown our footprint in Switzerland. We're very proud of the incredible talent that we have in Lausanne.

So with our increased investment and having a much larger employee base, we reached agreement with the government, and they were really great to work with, and they're proud of our -- the work we've done there. And because of that, there's kind of a onetime benefit that you saw this quarter. There's a couple of other smaller items as well on the U.S. tax side, we have a onetime larger deduction in the U.S. for foreign operations that basically is a standard kind of practice that we've gone through analyzed this.

And our tax team just did a phenomenal job in this past quarter. Those are onetime in nature. So if you look at the results this quarter, those will not repeat. If you think structurally, where is the company next year on a tax standpoint, the GAAP tax rate is going to be in the low 20% range. So low 20s on the GAAP side.

And of course, that can change. The share price has a fairly big impact on the overall GAAP tax rate. But I think low 20s from a GAAP standpoint. And the non-GAAP side for next year is going to be low teens, and that's sort of the cash tax rate that we pay plus accruals. So the non-GAAP tax rate is cash taxes paid plus accruals, low teens, GAAP low 20s. This quarter was really a onetime based on the really hard work that our team did and based on our investment in Switzerland, et cetera.

So we did provide guidance in the materials for this year, non-GAAP, 9% to 11%. So overall, though, I would -- in the models for next year count on the low teens non-GAAP, low 20s GAAP. Hanneke, do you want to talk about design?

Johanna W. Faber - Logitech International S.A. - CEO

Yes. Thanks for asking the question. Design plays a really, really special role at Logitech, and it's a real point of difference for us. Now Alastair, over the last decade, built a fantastic design organization. That's one of the other things I learned in my first 6 weeks. We have more than 200 internal designers at Logitech. And they're fantastic.

So actually, in the last quarter, they as a team won the Global Red Dot Design Team Award, which is again, in this industry and beyond a really prestigious award. So I'm thankful for the organization and the culture, the design culture that's been created at Logitech. And I think with the team that we have of designers. I have no doubt we're going to continue to excel in design. So thanks for asking.

Nate Melihercik

Our next question is from Martin Jungfleisch at BNP.

Martin Jungfleisch - BNP Paribas Exane, Research Division - Research Analyst

I hope you can hear me. And also congrats on the strong set of numbers. So maybe 2 questions. First one is coming back on the cost side. I think at the webinar in early December last year, you mentioned that R&D will remain a key focus area for you, and you also just pointed out a few innovations. Now in Q3, R&D costs are up 9%. Should we expect this cost line to keep increasing in that magnitude in the coming quarters as well?

And then the second question is on the China gaming curves. These routes have been taken off the website this morning. But just wondering if you have seen any negative impacts so far or if you would expect any negative impact? And also, if you could just remind us on the rough exposure that you have in China and gaming.

Charles D. Boynton - Logitech International S.A. - CFO

Yes, I didn't understand the comment that the China comment from this morning. In general, China gaming is a really important market for us. We have an iconic brand and the consumers in China preferentially pick our brand at the high end. There's lots of low-end competition. It's a big market. Overall, China's results were roughly flat. So we had -- Asia was down in general, so more challenging across Asia. But China, actually, we performed quite well relative to our expectations. Clearly, it's a big market and it's very competitive. But preferentially, they choose better technology and a better brand at the high end. Do you want to add anything on China before we talk about OpEx?

Johanna W. Faber - Logitech International S.A. - CEO

Yes. A very important, and I like what I'm seeing in terms of our premium offering there, so to Pro Light Mice for especially. And it's in any business, China is super competitive. That keeps us honest, so we'll be all over that market.

Charles D. Boynton - Logitech International S.A. - CFO

Great. And then on the OpEx question, I would expect engineering quarter-over-quarter to be roughly in line with the prior quarter. And I would expect G&A and sales and marketing to come down. And the reason I believe that is because sales and marketing has variable commissions tied to sales and with peak quarter to trough quarter, you have less commissions that you pay based on the sales change, just due to normal seasonality and then, of course, the onetime transition costs that you see in the G&A line.

So overall, R&D quarter-over-quarter should be roughly in line. And then, of course, next year, we'll have to talk about that at Analyst Day. But again, in total, I would be estimating roughly 25% of revenue in your models.

Nate Melihercik

Hanneke, Chuck. Our last question for today is from Michael Foeth at Vontobel.

Michael Foeth - Vontobel Holding AG - Head of Swiss Industrial Research

Just 2 last questions for me. The first one is on inventories. You obviously made a great job in reducing the inventory levels. My question is where sort of is the limitation to that inventory reduction. And if you can give a bit more specifics on the whole Red Sea situation? Any disruptions there in terms of your supply chains or delivery shipments and the related inventory that you would need to build up to counter that?

And then my second question would be and I'll ask it straight away. You mentioned, obviously, in terms of growth for 2025, the trajectory that you depicted in your shareholder letter. It leaves a little bit room for interpretation in terms of where the trajectory goes. It looks like it would go slightly into the positive but maybe not to that high single-digit growth. Is it correct that you're expecting it to turn slightly positive, but maybe not as fast as your long-term model suggest.

Charles D. Boynton - Logitech International S.A. - CFO

Certainly. On the inventory side, again, it was such an impressive quarter on inventory. We had -- we've stated now for the last few quarters that we want to drive down on-hand inventory and channel inventory. And I just want to thank our employees and our teams for executing on this plan because it's really, really paid massive dividends, improving linearity improving return on invested capital. Again, if you have less inventory, you have higher return invested capital or [ROACE,] as you say, in Europe or ROACE.

That is such an important metric. And we have driven down inventory levels 6.5 turns in the quarter is a really great number. We said our operating model is between 5% and 6%. That would be on an annualized basis. So again, we're going to go in now into our trough quarter. So the turns will probably come down. I don't think inventory will come down in Q4 with the Red Sea challenges. Is there more room? There is more room.

We can do better, but we're getting to that point of diminishing returns because importantly, we don't want stock outs. We want to carry inventory on in our distribution centers to meet our customers' demands. Customer SAT is #1, but we want to do that the right way. So I think we're approaching that point of the efficient frontier on inventory levels, and we're targeting 5% to 6% precautionary so good, maybe he can get to 7% occasionally.

But I would say 6% is kind of hitting that best-in-class or upper quartile. As it relates to the Red Sea, it adds about 4 weeks of lead time. So it's not that material. There will be an impact to air, as I mentioned earlier, and a little higher cost. So I would expect a little bit of inventory increase, maybe we can keep it flat, but I would expect a little bit of an inventory increase as we get into Q4.

And then the -- what was the last part, Hanneke? Do you...

Johanna W. Faber - Logitech International S.A. - CEO

The gradual growth, and does it leave room for interpretation?

Charles D. Boynton - Logitech International S.A. - CFO

I'll let you answer that one.

Johanna W. Faber - Logitech International S.A. - CEO

I'll go back to where we started. I think growth is really a question of when, not if. We will get back to growth. But there are so many uncertainties out there that we're just a little cautious on giving you exact numbers of when and how much.

Charles D. Boynton - Logitech International S.A. - CFO

We will at Analyst Day. So stay tuned. And in middle of May, we'll have an Analyst Day and talk about our view and our outlook. I think the idea now is just like be cautious going into next year. People are getting excited. And I think overall, it's a great business, a great operating model, but we need to be cautious looking out into next year given the uncertainties.

Nate Melihercik

And with that, Hanneke, that's our last question today.

Johanna W. Faber - Logitech International S.A. - CEO

Great. Well, thank you, Nate. Thanks, everyone. It's been really nice to meet you guys. Thanks for joining us for your interest in Logitech. And of course, a huge thank you to all the Logitech teams around the world for everything they continue to do. I look forward to speaking with you guys next quarter. Take care.

Charles D. Boynton - Logitech International S.A. - CFO

Thank you.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2024, Refinitiv. All Rights Reserved.