December 2020

Logitech

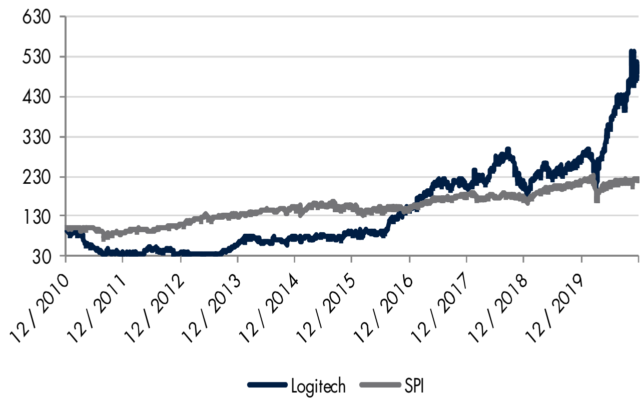
Market profile

Country	Switzerland
Sector	Technology
Market cap (CHF bn)	13.3
52-week high / low (CHF)	89.62 / 28.67
Price per share (CHF)	77.04

Key metrics (USD)

	2020	2021e	2022e
EPS	2.66	3.35	2.73
PE	15.7x	23.3x	28.5x
EV/EBITDA	14.4x	15.6x	17.1x
Dividend yield	1.7%	0.9%	1.3%

Evolution of stock price with respect to benchmark (rebased)
Source: IAM



Executive summary

Logitech is a world leader in designing, manufacturing and marketing products that help connect people to digital and cloud experiences. More than 35 years ago, Logitech created products to improve experiences around the personal computer (PC) platform, and today it is a multi-brand, multi-category company designing products that enable better experiences consuming, sharing and creating digital content such as computing, gaming, video and music, whether it is on a computer, mobile device or in the cloud. Logitech's brands include Logitech, Logitech G, ASTRO Gaming, Streamlabs, Ultimate Ears, Jaybird, and Blue Microphones.

Historically, Logitech's business has been driven by the same trends that drove the adoption of desktop and laptop PCs for consumers, businesses and institutional applications, including the growth in affordable processing power, communications bandwidth, the increased accessibility of digital content, and the growing and pervasive use of the Internet for productivity, communication and entertainment. More recently, the democratization of content creation, the rising trend of electronic sports (e-sports), the growth of streamers and creators and the expansion of video everywhere have created multiple opportunities for Logitech to drive greater interaction and engagement between people and digital content.

The recent growth in revenues has been boosted by the COVID pandemic. This exceptional growth rate is clearly a risk, as we don't know how much future sales has been brought forward. Logitech products are buy once and forget; you don't need to upgrade your keyboard, mouse or webcam every year. For these reasons, we think future growth should be closer to 6-7% (about double the world's GDP growth rate).

The biggest risk to the current share price is the high valuation. If both EPS and growth rates slow down, the share would be impacted doubly as investors reassess the PEG (P/E to Growth) ratio.

Logitech

Daniel Pfund, Senior Financial Analyst **December 2020**

Company description

Logitech is a world leader in designing, manufacturing and marketing products that help connect people to digital and cloud experiences. More than 35 years ago, Logitech created products to improve experiences around the personal computer (PC) platform, and today it is a multi-brand, multi-category company designing products that enable better experiences consuming, sharing and creating digital content such as computing, gaming, video and music, whether it is on a computer, mobile device or in the cloud. Logitech's brands include Logitech, Logitech G, ASTRO Gaming, Streamlabs, Ultimate Ears, Jaybird, and Blue Microphones.

Logitech sells their products to a broad network of domestic and international customers, including direct sales to retailers and e-tailers, and indirect sales through distributors. Their worldwide channel network includes consumer electronics distributors, retailers, mass merchandisers, specialty stores, computer and telecommunications stores, value-added resellers and online merchants.

Revenues are split into 5 divisions:

1. Creativity & Productivity
2. Gaming
3. Video Collaboration
4. Music
5. Smart Home

Creativity & Productivity

This is by far Logitech’s biggest division, as it stems from its historic roots. In this division, we find several sub categories:

- Pointing Devices: PC and Mac-related mice, trackballs, touchpads, and presenters.
- Keyboards & Combos: PC keyboards, living room keyboards, and keyboard/mice combo products.
- PC Webcams: PC-based webcams targeted primarily at consumers.
- Tablet & other accessories

Fig.1: Logitech brands and logos
Source: Company data, IAM research

Fig.2: Logitech's products include keyboards, mice, cameras, and microphones
Source: Company data, IAM research

Gaming

The gaming division comprises gaming mice, keyboards, headsets, gamepads, steering wheels, simulation controllers, console gaming headsets, console gaming controllers, and the newly acquired Streamlabs services. Streamlabs is a software that allows content creators to easily live stream their content to different platforms such as Twitch, YouTube Live, and Facebook Live.

Video Collaboration

Video Collaboration (VC) includes Logitech's ConferenceCams, which combine affordable enterprise-quality audio and high definition (1080p) video to businesses of any size. This division caters only to businesses, as consumer grade PC webcams are included in the Creativity & Productivity division.

Music

This division includes Bluetooth wireless speakers (mobile speakers) as well as PC speakers, PC headsets, in-ear headphones, and studio quality microphones for professionals and consumers.

Smart Home

This is Logitech's smallest division (only 2% of total sales) and includes their Harmony line of advanced home entertainment controllers and home security cameras. This division's revenue has decreased significantly over the last two years and it remains unclear if Logitech intends to keep it or sell it.

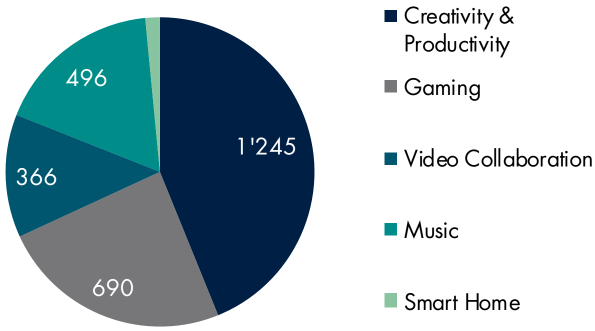
History of the company

Logitech was founded in Apples, Vaud in 1981 by Stanford alumni Daniel Borel and Pierluigi Zappacosta, and former Olivetti engineer Giacomo Marini. Mr. Borel served as chairman from 1982 to 2008 and served as the company's CEO from 1982-1988 and again from 1992-1998. He still holds a small minority participation in the company (3%) but is no longer active on the board of directors, although he was promoted "Chairman Emeritus".

Logitech's roots stem from the computer mouse, and the company evolved to become the world's largest manufacturer of computer mice and other personal interface products. The name Logitech is derived from "logiciel" (French word for software).

The company was first listed in Switzerland in 1988, and on the Nasdaq in 1997.

Fig.3: Revenues by segment
Source: Company data, IAM research

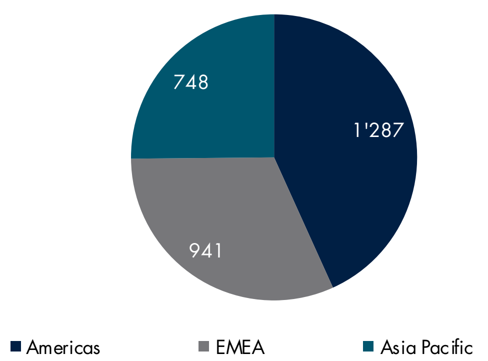


A big turning point came in 2008 when Logitech acquired Ultimate Ears for USD 34 million, a supplier of then custom in-ear monitors for professional musicians and Bluetooth speakers for the consumer market. That was the start of a significant buying spree and diversification outside of mice/keyboards. In 2009, Logitech acquired Lifesize Communications, a provider of business video conferencing equipment. But this segment proved tough to conquer, as Logitech was not an enterprise name, so in 2016, this division was spun off.

Geographic exposure

Logitech discloses revenues in three distinct geographic zones: Americas, Europe Middle-East and Africa (EMEA), and Asia Pacific. There is not a lot of granularity. Americas (mainly North America) makes up the biggest proportion of sales. Logitech has a headquarter in the United States, and its accounting figures are reported in US dollars.

Fig.4: Logitech revenues by geography (USD mn)
Source: Company data, IAM research



Industry Overview & Competitive positioning

Historically, Logitech's business has been driven by the same trends that drove the adoption of desktop and laptop PCs for consumers, businesses and institutional applications, including the growth in affordable processing power, communications bandwidth, the increased accessibility of digital content, and the growing and pervasive use of the Internet for productivity, communication and entertainment. More recently, the democratization of content creation, the rising trend of electronic sports (e-sports), the growth of streamers and creators and the expansion of video everywhere have created multiple opportunities for Logitech to drive greater interaction and engagement between people and digital content.

In the last several years, new PC shipments have stagnated and, combined with increased interest in smaller, mobile computing devices (such as smartphones and tablets), the market for PC peripherals has rapidly changed. Nevertheless, Logitech can still capitalize on existing opportunities within the large installed base of PCs, created by consumers' desire to refresh their current PCs with new peripherals, as well as new trends developing within the connected device ecosystems. In addition, the refresh of operating systems and new use cases created by the growth of specific cloud-based services and applications drive new peripherals opportunities. Consumers are also enhancing their tablet experience with a range of keyboards and cases that enable them to create, consume and do more with their tablets conveniently and comfortably.

Growing adoption of cloud-based experiences in gaming, video, music and smart home has expanded the total addressable market opportunities for the company. More and more consumers today interact with cloud-based content platforms, such as Steam and Twitch for gaming or Zoom, Google Meet, and Microsoft Teams for video collaboration. Logitech offers peripherals and accessories to enhance the use of such cloud-based content platforms.

In the gaming market, the rapid rise of e-sports and the growth of live streamers on platforms such as Twitch and broadcasters on platforms such as YouTube continue to drive growth. Logitech can leverage their deep research and development (R&D) capabilities in the area of PC peripherals to develop industry-leading gaming gear that enhances consumers' overall gaming experience and performance. As consumers increasingly watch various e-sports tournaments or other gaming broadcasts on cloud-based platforms such as Twitch, the gaming industry is becoming both a source of entertainment and participation by mainstream consumers.

The adoption of video everywhere, in large and small conference rooms and at home, is a continuing trend that has accelerated during the COVID-19 pandemic. The video communication industry continues to make progress toward a vision in which people can conduct a video call from any of a variety of platforms - video-enabled rooms, PCs, laptops and mobile devices such as tablets and smartphones - to any other platform. This trend to embrace cloud video conferencing by businesses and institutions and, in particular, the growing adoption of remote work, distance learning, and telemedicine, is driving Logitech’s Video Collaboration category and offers a long-term growth opportunity for the company. For businesses and institutions, video conferencing is increasingly substituted for travel, because of high travel costs as well as the productivity gain that can be achieved by a high quality face-to-face meeting that does not require travel away from the office. For some schools, distance learning has become a complementary or, in some cases, an alternative way to educate students. Further, with the increased availability of high Internet bandwidth, video conferencing is becoming a key component of Unified Communications, which is the integration of communications solutions such as voicemail, e-mail, chat, presentation sharing and live video meetings. The market opportunity to provide innovative, affordable, and easy-to-use video collaboration products to the millions of small- to medium-sized meeting rooms lacking video is substantial, and we think that Logitech is well-positioned to take advantage of that opportunity. Eventually the company could even expand into large-sized meeting rooms, although the failed Lifesize acquisition and spin-off does not presage an easy path.

Cloud-based music services have enjoyed tremendous growth, fueled by the adoption of smartphones, tablets, and other connected devices. Consumers are optimizing their audio experiences on their tablets and smartphones with wireless mobile speakers that pair easily with their mobile devices and with in-ear and other headphones. Logitech's mobile speakers and in-ear headphone products target a large market that reflects the increasing popularity of mobile devices or various voice assistants for accessing digital music, although near-term growth has slowed in some markets. Additionally, within the music market, consumers are increasingly listening with wireless earphones while they undertake activities such as sports and fitness. The innovation in truly wireless headphones has led to double-digit industry growth in revenue and average selling price, which highlights a growth opportunity for Logitech.

The home is also an important place for technological development, particularly as an increasing number of objects become connected smart home devices such as home security cameras, light bulbs, security locks, thermostats and others. Logitech's line of universal remotes and hubs control electronic and connected devices around the home, including these and other smart devices.

Finally, due to travel/transport restrictions during the COVID-19 pandemic, a lot of people invested in gaming equipment, as this is a cheap way to entertain oneself. On top of this, the console market is undergoing a major upgrade cycle (Microsoft's X-Box Series X, and Sony's Playstation 5 have both been released in late 2020), and this clearly will benefit Logitech.

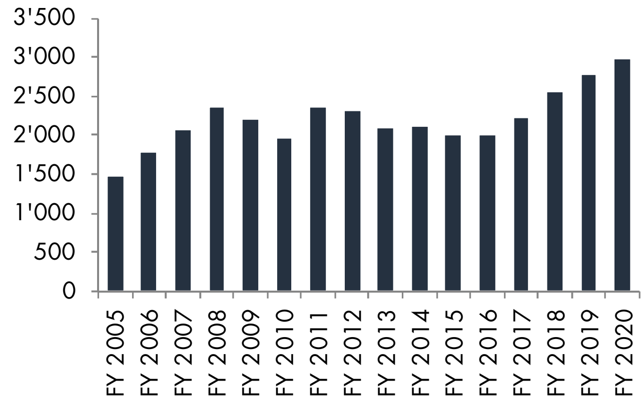
Fig.5: Logitech's racing wheel includes TRUEFORCE, a high definition feedback system based on the game's physics
Source: Company data, IAM research

Financial analysis

Growth

The following figure depicts Logitech's top-line growth.

Fig.6: Revenues
Source: Company data, IAM research



The 15 year compound annual growth rate is 4.8% per annum. But more interestingly, the recent 5 years growth has been higher, at 8.2% per annum. This higher growth rate is more relevant because Logitech has transformed itself and is progressively getting out of lower margin, lower growth, commodity type businesses.

Of course, we cannot extrapolate the recent growth, which has been boosted by the COVID pandemic. This exceptional growth rate is clearly a risk, as we don't know how much future sales has been brought forward. Clearly, Logitech products are buy once and forget; you don't need to upgrade your keyboard, mouse or webcam every year. For these reasons, we think future growth should be closer to 6-7% (about double the world's GDP growth rate).

A large proportion of future growth will come from higher penetration of new products. The company thinks that it will be at least "several years" before they reach a plateau in sales with current category products, at which point they will be looking at acquiring a new growth category. This strategy is obviously not reliable and predictable, and remains one of the main risks (see discussion in Risks section later).

Margins

Gross margins are a relevant metric for Logitech because they can vary quite a lot from year to year (not to mention, quarter to quarter). The reason for this variability is Logitech's mix of products sold, cost and manufacturing efficiencies, tariffs, and logistic costs (both on the procurement and distribution sides). Indeed, if Logitech has not correctly forecast demand, it needs to bring finished products by airplane instead of lower cost sea freight to their final destination.

Operating margins (adjusted EBIT) are shown in the following graph.

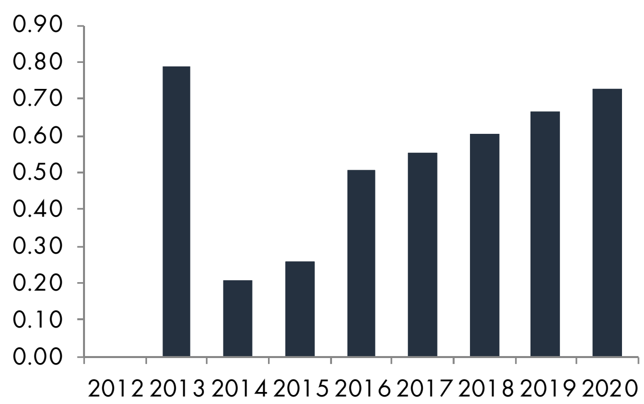
Fig.7: Adjusted EBIT margin
Source: Company data, IAM research

As we can see, operating margins are on an increasing trend, although not on a linear basis. In the past, Logitech was very dependent on PC sales, which itself was dependent on operating system renewal cycles. Operating margins remain dependent on top-line growth, so a certain amount of cyclicality will remain, even if the company has diversified away from pure PC products.

Dividend

The following figure shows Logitech's dividend history.

Fig.8: Dividend per share
Source: Company data, IAM research



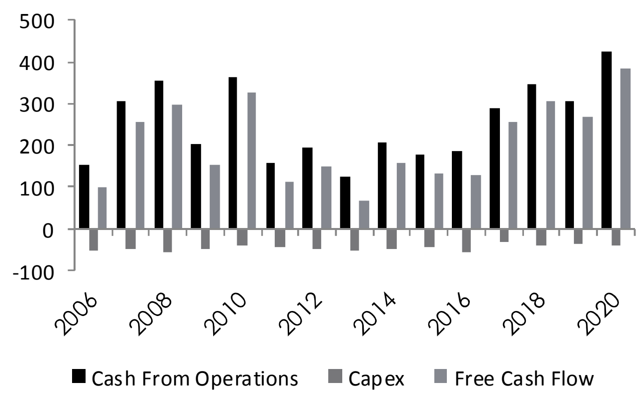
Logitech is clearly not an attractive dividend play, with a paltry 1.3% yield. Obviously the company prefers to keep the cash internally to make further acquisitions and grow future revenues. This makes sense, as Logitech must be seen as a growth company, not a value play.

Also, we must not forget that the company has an active share buyback program in place. For example, in last fiscal year, the company has brought back USD 113 million in shares, which is just slightly less than the dividend paid (USD 123 million).

Free Cash Flow

The following figure shows Logitech's operating cash flows, capex and free cash flow over time.

Fig.9: Operating cash flow, capex and free cash flow
Source: Company data, IAM research

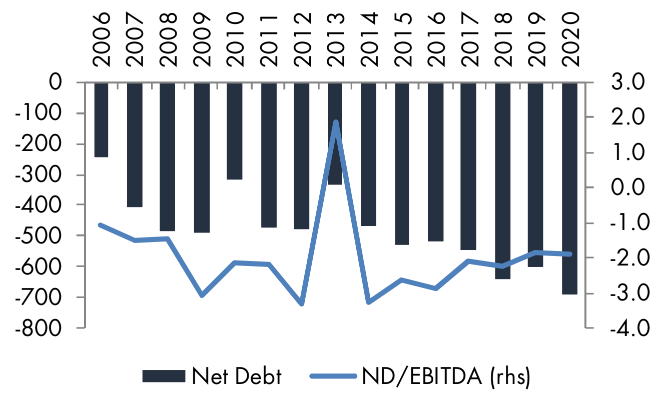


As we can see, Free Cash Flow has always been positive over this period. This is especially true because capital expenditures are extremely low (between USD 40 and USD 60 million/year). Indeed, Logitech owns only one factory in Suzhou, China and this has been largely amortized over its lifetime. In case of extra capacity needs, Logitech has contracts in place to outsource manufacturing to several contract manufacturers in China. We can consider that capex is mainly maintenance capex, so at very low levels (with an order of magnitude of 1.5% to 2% of sales).

Balance Sheet

The following chart shows Logitech's net debt (ND) as well as a common indebtedness ratio (ND/EBITDA).

Fig.10: Net debt and Net debt/EBITDA
Source: Company data, IAM research



As seen, net debt has always been negative (ie: a net cash position). Logitech has a very solid balance sheet, and one could even argue that it has too much cash on hand. This is a double edged sword, as investors worry that the company will use that mountain of cash to acquire companies in new domains. Unfortunately, the acquisition track record of Logitech has not always been very good, so this is clearly a risk.

Investment case

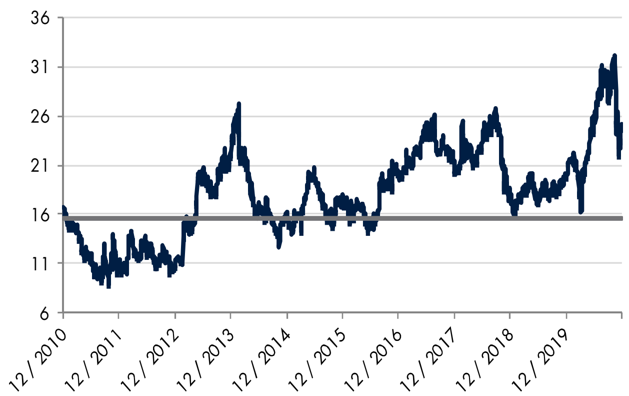
Logitech is a very shareholder oriented company. Management's incentives are directly aligned with shareholders' as they are required to hold a certain minimum amount of shares. For example, the CEO needs to hold at minimum 5 times the market value of his annual base salary (USD 925'000) in Logitech shares. The CFO needs to hold at minimum 3 times the market value of his annual base salary in Logitech shares. Executive directors need to hold at least 2 times the market value of their respective annual base salary in Logitech shares. If Logitech's market value falls below those thresholds, management has up to 2 years to return to compliance by acquiring shares.

The CEO's base salary only corresponds to 12% of his total potential compensation. The rest is linked to incentive targets and mostly stock options, so again this aligns the company's interests with those of the shareholders'.

Valuation

The following chart depicts Logitech's next 12 months forward P/E multiple over the past decade.

Fig.11: 12M forward P/E over last decade
Source: IAM research



Unfortunately, this is the major negative point to purchasing Logitech shares short term. As the company has been seen as a COVID pandemic gainer, with the stay at home phenomena, investors have bid up shares to a very high level, on peak EPS levels. This is a double risk, as EPS could fall quickly back to lower levels, exposing an even higher valuation. Typically, tech investors value companies on P/E to growth ratios (PEG), so if both the EPS and growth fall, this could dramatically impact the share price.

Risks

COVID-19

While the COVID-19 pandemic is usually a negative risk for companies, for Logitech, this has been a massive driver of revenues. For this reason, it is unclear how much future growth has been brought forward when people invested for work at home equipment or home entertainment (gaming).

Furthermore, we have witnessed a very weak share price as soon as better news was announced on the vaccines front. Obviously, investors have purchased Logitech shares on the basis of the "stay at home" theme, and are just as likely to sell them when the pandemic is over.

Acquisitions

Because Logitech has so much extra cash on its balance sheet, investors are worried that the company will use it to make acquisitions. Logitech's track record of acquisitions is rather muted, so this is a real risk. Nevertheless, management is aware of this issue and has promised to return more money to shareholders via a share buyback. In May of 2020, the company announced its intention to return up to USD 250 million to shareholders via a share buyback over 3 years (which is not particularly impressive as it compares to USD 113 million bought back last year). At the same time, the company also increased its dividend for the year by 10%, which reassured investors somewhat that management is dedicated to consistently return cash to shareholders.