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Q3 2021 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome the Garmin Ltd. Third Quarter 2021 Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to your first speaker today, Ms. Teri Seck. Ma'am, please go ahead.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning. We would like to welcome you to Garmin Ltd.'s Third Quarter 2021 Earnings Call. Please note that the earnings, press release and related slides are available at Garmin's Investor Relations site at www.garmin.com/stock. An archive of the webcast and related transcript will also be available on our website.

This earnings call includes projections and other forward-looking statements regarding Garmin Ltd. and its business. Any statements regarding our future financial position, revenues, earnings, gross margins, operating margins, future dividends, market shares, product introductions, future demand for our products and plans and objectives are forward-looking statements. The forward-looking events and circumstances discussed in this earnings call may not occur, and actual results could differ materially as a result of risk factors affecting Garmin. Information concerning these risk factors is contained in our Form 10-K and Form 10-Q filed with the Securities and Exchange Commission.

In particular, there is significant uncertainty about the duration and impact of the COVID-19 pandemic. This means that results could change at any time, and any statement about the impact of COVID-19 on the company's business results and outlook is the best estimate based on the information available as of today's date.

Presenting on behalf of Garmin Ltd. this morning are Cliff Pemble, President and Chief Executive Officer; and Doug Boessen, Chief Financial Officer and Treasurer. At this time, I would like to turn the call over to Cliff Pemble.

Clifton Albert Pemble *Garmin Ltd. - President, CEO & Director*

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin reported record revenue of \$1.2 billion for the third quarter, increasing 7% over the pandemic fuel levels we achieved in the prior year. Operating income declined year-over-year to \$283 million due to a combination of higher freight costs affecting gross margin and increased expenses as we invest in R&D, information technology and marketing initiatives. Operating margin was very strong at 23.7%.

There are 2 things to consider when looking at our performance in the back half of the year. First, financial comparisons to the prior year are more challenging due to the pandemic-driven demand and retail disruptions of 2020. Also, we are facing one of the most challenging supply chain environments in history. Our vertically integrated business model and commitment to safety stock was a key factor driving revenue growth for the quarter, but supplies are tight, and we expect freight costs to remain elevated as we rush to fill retail shelves in time for the important holiday selling season. I'm pleased with what we've accomplished in this tough environment, and I'm very proud of our team who've worked tirelessly to maintain continuity to supply from our factories to customers.

Last time, I mentioned that we invested in a fourth production facility in Taiwan. I'm pleased to report that this facility is operational and

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will help us fill more orders during the important holiday selling season.

Given our strong performance in the first 3 quarters of the year, we're updating our full year guidance. We now anticipate revenue of approximately \$4.95 billion, up 18% over the prior year, with double-digit growth expected in each of our 5 business segments. In a moment, Doug will provide more details on our financial results and updated guidance, but first, I'll provide a few highlights for each business segment.

Starting with fitness. Revenue increased 4% to \$342 million, with growth driven primarily by cycling products and advanced wearables. Our Connect IQ development platform is a strong differentiator for us, and we are deploying it across a broader range of Garmin devices. We recently held our fifth Annual Developer Conference, where we announced a partnership with Dexcom to deliver real-time glucose information via the Connect IQ app on selected smartwatches and cycling computers, even during activities. Fitness segment revenue has grown 26% year-to-date, and we are maintaining our revenue growth estimate of 17% for the year.

Moving to outdoor. Revenue decreased 3% to \$324 million. The decrease in revenue is due to the strong sell-in activity associated with the launch of our solar adventure watches in the prior year quarter and limited supplies of traditional handheld and dog products in the current quarter. During the quarter, we launched the APPROACH R10, our first portable golf monitor. The R10 can be used on course or at home to help golfers improve their game with more than a dozen key metrics shown in real time. Customers are very enthusiastic about the R10, and it's on its way to becoming another halo product for Garmin. Outdoor segment revenue has grown 26% year-to-date, and we are maintaining our growth estimate of 17% for the year.

Looking next at Aviation. Revenue increased 19% to \$180 million, with growth in both OEM and aftermarket product categories. During the quarter, we were ranked #1 in avionics product support by Aviation International News for the 18th consecutive year. Being consistently recognized for unrivaled support year after year clearly shows our strategic focus on taking care of customers and standing behind our products. We launched Smart Glide, a game-changing safety feature inspired by Autoland technology that will help pilots manage loss of engine power by automatically flying the optimal glide ratio and navigating to the best available airport.

Also in the quarter, we announced the certification of the GFC 600H flight control system on the Bell 505 helicopter. This advanced autopilot includes state-of-the-art safety features, such as electronic stability control and a hover-assist mode. We are pleased with how the Aviation segment has recovered so far this year, and now expect full year revenue guidance to increase approximately 12%.

Turning next to the Marine segment. Revenue increased 25% to \$208 million, with growth across multiple categories, led by chartplotters. We continue to be recognized for innovation and achievements in the marine industry. For the seventh consecutive year, the National Marine Electronics Association named Garmin Manufacturer of the Year, and we also received 5 Product of Excellence awards.

During the quarter, we introduced Surround View, the industry's first intelligent camera system that provides a 360-degree bird's eye view around the vessel. We also announced our partnership with Malibu Boats. Our 7-inch touchscreen displays will be standard equipment across the Malibu axis boat line, beginning with the 2022 model year. Given the strong year-to-date performance on the Marine segment, we are raising our revenue growth estimate to 30% over the year.

And looking finally at auto, revenue increased 7% to \$138 million, with growth primarily driven by OEM programs. During the quarter, we began production shipments of the BMW computing module from our Olathe, Kansas manufacturing facility, and we delivered prototypes of the next-generation BMW system from our new manufacturing facility located in Poland.

We also recently announced a refreshed lineup of Drive Navigators for the consumer auto segment. These devices offer larger, higher-resolution displays as well as enhanced connected features. Given the strong year-to-date performance of the Auto segment, we are raising our revenue growth estimate to 17% for the year.

That concludes my remarks. Next, Doug will walk you through additional details on our financial results and updated guidance. Doug?

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Douglas Gerard Boessen *Garmin Ltd. - CFO & Treasurer*

Thanks, Cliff. Good morning, everyone. I'll begin by reviewing our third quarter financial results, provide comments on the balance sheet, cash flow statement, taxes, our updated guidance. We posted revenue of \$1,192,000,000 for the third quarter, representing a 7% increase year-over-year. Gross margin was 58.4%, 180 basis point decrease compared to prior year quarter. The decrease was primarily due to higher freight costs. Operating expense as a percentage of sales was 34.7%, 310 basis point increase to the prior quarter. Operating income was \$283 million, 11% decrease. Operating margin was 23.7%, a [290] basis point decrease. Our GAAP EPS was \$1.34. Pro forma EPS was \$1.41.

Next, with our third quarter revenue by segment. We have a highly diverse business model, provides a rich set of opportunities, reduce our reliance on single markets and product lines. In the third quarter, we achieved growth in 4 of our 5 segments, double-digit growth in both Marine and Aviation. Fitness is our largest segment, contributing 29% of the sales in the third quarter, followed by Outdoor at 27%.

Moving to our revenue by geography. The Americas and EMEA regions grew 10% and 9%, respectively. The APAC region decreased 2%. The Americas region contributed nearly 1/2 of our revenue, the remaining coming from the EMEA and APAC regions.

Looking next, operating expenses. Third quarter operating expenses increased by \$62 million or 18%. Research and development increased \$39 million year-over-year, primarily due to engineering personnel costs. SG&A increased \$21 million compared to prior year quarter, primarily due to increases in personnel-related expenses and information technology costs. Our advertising expense increased approximately \$3 million due to higher media spend.

A few highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with cash and marketable securities worth \$3.2 billion. Accounts receivable decreased sequentially and year-over-year to \$639 million. Inventory balance increased, both a sequential year-over-year basis, to \$1.1 billion, primarily due to raw material requirements in preparation for the seasonally strong fourth quarter. During the third quarter 2021, we generated free cash flow of \$204 million, a \$32 million decrease compared to prior quarter. Capital expenditures for the third quarter were \$41 million. We expect full year 2021 free cash flow to be approximately \$750 million, capital expenditures of approximately \$325 million And a third quarter of 2021 for an effective tax rate of 5.9% compared to 6.9% in the prior year. The decrease was primarily due to impact to return provision adjustments, associated with filing the U.S. tax return.

Turning next to our full year guidance. We estimate revenue of approximately \$4.95 billion, increase of 18% for the prior year, double-digit growth in each of our segments. We expect gross margin to be approximately 58.2%, which is lower than our previous guidance, 58.5%, due to higher freight costs. We expect an operating margin of approximately 24%. Also, we expect the full year 2021 pro forma effective tax rate to be approximately 11.5%, which results in pro forma earnings per share of approximately \$5.60.

This concludes our formal remarks. Rachel, can you please open the line for Q&A?

Teri Seck *Garmin Ltd. - Manager of IR*

Thanks, everyone, for your time today. Have a great day. Bye.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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