
MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen. Welcome to the Garmin Third Quarter 2010 Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn things over to Ms. Kerri Thurston, Director of Investor Relations. Please go ahead ma'am.

Kerri Thurston, Investor Relations Manager

Thank you, Aaron. Good morning. We'd like to welcome you to Garmin Limited Third Quarter 2010 Earnings Call. Please note that a copy of the press release concerning this earnings call is available at Garmin's Investor Relations website on the internet at www.garmin.com/stock.

Additionally, this call is being broadcast live on the Internet. Please note that this webcast does include slides, which can be viewed during the call. An archive of the webcast will be available until December 3, 2010, and a transcript of the call will be available on the website under the Events Calendar tab.

This earnings call includes projections and other forward-looking statements regarding Garmin Limited and its business. Any statements regarding our future financial position, revenues, earnings, market shares, product introductions, future demand for our products, and forward-looking 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 our risk factors is contained in our Form 10-Q for the quarter ended June 2010 filed with the Securities and Exchange Commission. Attending this call on behalf of Garmin Limited this morning are Cliff Pemble, President and Chief Operating Officer; and Kevin Rauckman, Chief Financial Officer and Treasurer. The presenters for this morning's call are Cliff Pemble and Kevin Rauckman.

At this time, I'd like to turn the call over to Cliff.

Clifton Pemble, President and Chief Operating Officer

Good morning, everyone. I will begin my remarks with highlights from our earnings press release followed by more detailed comments by segment. Our third quarter results included revenue and operating income growth in the Outdoor/Fitness, Marine and Aviation segments. We sold 3.8 million units in the quarter, which represents year-over-year decline of 1%.

Auto PND unit volume was weaker, however, this was offset by increased volumes in OEM and nüvifone, and our other business segments also contributed with increased unit volumes. In our Outdoor/Fitness division, we acquired one of the leading innovators of cycle power MetriGear. We're excited about the addition of MetriGear to the Garmin family, and I'll provide additional details on what this means for our Fitness division later in my remarks.

During the quarter, we redeployed nüvifone R&D resources, effectively winding down our activities targeted towards handset development. These resources are now focused on other growth segments of our business including Auto OEM, Outdoor/Fitness and mobile applications.

Finally, we generated \$195 million in free cash flow during the quarter, strengthening our balance sheet, and we repurchased 4.3 million shares of our stock.

Moving now to segment highlights. In our Marine segment, we reported year-over-year revenue growth of 1%, which fell below our expectations and represented a significant slowdown from the robust pace of growth reported during the second quarter.

The momentum that we experienced in the second quarter faded shortly after the July 4th holiday, and this experience was shared by many of our OEM and retail partners.

We expect weaker trends to continue in the fourth quarter, however, we believe our full-year results will be in line with our earlier projections.

Despite the weakness in revenue growth, we experienced healthy growth in operating income over Q3 of last year, driven by higher gross margins as well as reduced expenses within the segment. We remain focused on expanding our product offerings and gaining additional share in both the retail and OEM markets, as we believe this segment offers strong long-term growth and profit potential.

Highlighting progress in the OEM category, Garmin was selected by the American Boatbuilders Association as a preferred supplier of choice. This selection improves our business relationship with the 13 member OEMs who collectively produce more than 15% of all boats, 16 feet or larger in North America.

Also in the quarter, we introduced our first sailboat-specific autopilot, which expands our addressable market in the Marine segment. The GHP 12 is designed primarily for sailboats, 20 to 70 feet in length and operates on the NMEA 2000 network for easy installation and configuration.

Moving next to Aviation, revenue grew 4% year-over-year driven by growth in both portable and OEM product lines. Our operating income grew a respectable 40% on improved gross margins and through operating leverage in the segment.

For the year, we have experienced growth both in OEM and retrofit product lines, despite indicators, which show that recovery of the Aviation market lags that of the general economy. We remain focused on opportunities such as expanding addressable markets with additional retrofit product offerings as well as expansion into the Part 25 business jet market.

At the recent NBAA trade show, we announced the G5000 integrated cockpit system designed specifically for Part 25 business jets. The G5000 meets the requirements of Part 25 operation, while offering all the features and ease of use that the aviation community expects to see from Garmin. We are delighted that our new system has already been selected by Cessna for the new Citation X business jet.

The Citation X has a legacy of high performance, and this new model will exceed the credentials of its predecessor. We believe the G5000 is a wonderful complement to this already impressive aircraft.

We also announced a new integrated cockpit for the King Air 300 and 350 series with certification planned in the mid 2011 timeframe. This retrofit program expands our addressable market for integrated cockpit systems and enables King Air owners to revitalize their aircraft with state-of-the-art avionics.

Finally, we were pleased to be selected by Federal Express for a significant retrofit program. Over the next five years, FedEx plans to equip 250 Cessna Caravans with our G600 Aviation suite. This retrofit will be a welcomed enhancement for FedEx pilots, and will help FedEx further leverage their investment in this workhorse aircraft platform.

Turning next to the Outdoor/Fitness segment, we achieved year-over-year revenue growth of 9% which was sequentially lower than previous quarters due to the stronger comparables we faced from Q3 and Q4 of 2009. This segment again posted strong operating margin performance, coming in at 47% for third quarter and operating income grew 28% on stronger revenues and gross margin.

Ongoing growth in this segment combined with a strong margin profile allowed it to contribute 41% of consolidated operating income for the quarter. We're excited about the Outdoor/Fitness segment as we approach the holiday selling season as our suite of product offerings are stronger than it has ever been. We have a strong number of exciting introductions that I'll highlight shortly.

However, with the strong comparables of 2009, revenue growth will be below levels experienced in the first half of this year.

As mentioned earlier, during the quarter, we acquired MetriGear, the inventors of an innovated new our solution for cyclists known as Vector. The Vector solution allows power to be measured at the pedals which simplifies the installation and enhances the utility of information provided to the rider. New products from this acquisition are expected to be introduced in the back half of 2011.

During the quarter, we announced some new exciting products for the cycling and running market in time for the holiday season. For the runners, we introduced the Forerunner 210 and 410. The 210 builds on the simplicity of the successful Forerunner 110 adding training features and alerts. The 410 builds on our best-selling Forerunner 405 product line with improved touch bezel and significant software enhancements including customization of training pages and advanced workout capabilities.

And for cyclists, we introduced the Edge 800, which features the 2.6-inch color touch screen display. The device can be customized with various mapping options to meet the needs of each customer. It will track speed, distance, time, position, elevation, calories, climb and descent, then download all this data via our ANT+ wireless networks to the Garmin Connect Fitness portal for customer review and analysis, making this the most robust cycling computer in the market today.

In the Auto/Mobile segment, we experienced a 19% year-over-year revenue decline driven by declines in both unit volume and ASP. Looking back, the Q3 2009 ASP was positively impacted by the timing of new product releases, product mix as well as strong map and accessory sales. While the latest market research is not yet available, we believe our trends in unit volume were favorable to the overall market trends pointing to increase global market share.

We experienced strong triple-digit revenue growth in OEM products, which helped to partially offset the decline in PNDs. I will highlight some of the good news we see in the OEM market in just a moment. As mentioned earlier, we redeployed our mobile handset R&D throughout the organization, which will help us bring new products to market faster, and will help us explore new market opportunities. Garmin will expand its mobile handset application development and will offer navigation and other applications through a variety of application stores.

Looking forward, we expect the PND market to continue contraction in the fourth quarter driven by market saturation as well as substitute solutions. While this is not exciting news for investors, we are confident this business segment will continue to generate strong cash flow going forward. We will continue to focus on maintaining our market share on new opportunities in emerging markets and growing our share of business with OEMs.

Last year Chrysler announced the availability of Garmin Navigation in the 2011 Jeep Grand Cherokee and we're pleased to report that this relationship has been expanded to include additional makes and models in the Chrysler lineup including the new Dodge Charger and many others. We will be providing further details on the expanded relationship in weeks to come. We also announced the extension of our relationship with Suzuki, who will offer our nüvi 1690 Connected

Navigation device in their 2011 Grand Vitara and SX4 SUVs. Connected Navigation provides drivers with access to all the premium navigation service offerings including real-time traffic, weather, fuel prices and Google local search.

Finally, I would like to update you on our 2010 guidance. On the top line, the revenue range has been lowered to \$2.65 to \$2.75 billion based on the softness in the PND and Marine markets. However, the growth in operating margin ranges have been raised to reflect continued strong margin performance for the total company.

The pro forma EPS range excluding the impact of foreign currency exchange and one-time tax reversal is \$2.70 to \$2.90 for the year. This concludes my business update. And next, I'll turn the call over to Kevin who will walk us through our financial results in more detail. Thank you.

Kevin Rauckman, Chief Financial Officer and Treasurer

Thanks, Cliff. Good morning everyone. I would like to start with the income statement for the third quarter. As you saw the press release, we announced revenue of \$692 million, net income of \$280 million with a pro forma EPS of \$0.70 per share, which excludes our foreign currency gain and one-time tax adjustment during the period.

Revenues decreased 11% year-over-year. Our gross margin came in at 49.7%, a 280 basis point decline from the prior year. We announced operating margins of 24.1%, which was down from last year of 30.3%. Our gross margin, as I said, was 280 basis points unfavorable, however, advertising was flat as a percentage of sales, and down \$5 million on a year-over-year basis. SG&A costs was 50 basis points unfavorable, and down \$4 million on a year-over-year basis. And R&D was 290 basis points unfavorable, up \$13 million over the year ago quarter.

The pro forma EPS of \$0.70 represents a 31% decrease year-over-year on declining revenues and margins, and an increase to 22% of our effective tax rate. In the third quarter, we reversed significant tax reserves recorded for 2006 to 2008 based on the completion of review by various tax authorities and the expiration of the statute of limitations. This is a credit of \$114 million or \$0.59 of diluted EPS. Excluding the one-time tax reversal, we expect our full year tax rate to be approximately 20%.

Units shipped during the year were down – during the quarter – were down 1% year-over-year, as 3.8 million units were delivered during the quarter. The total company average selling price was \$182 per unit, down 10% from a very strong ASP in 2009. But this ASP was flat sequentially as pricing continues to stabilize in the Auto/Mobile segment.

The Auto/Mobile ASP decreased 15% compared to prior year to \$149 from \$175 a unit. The Auto/Mobile ASP was up slightly on a sequential basis from \$144 a unit to \$149 a unit.

The non-GAAP measures that we reported represent net income per share excluding the effect of foreign currency translation in the current quarter and 2010 year-to-date, also using the impact of a one-time reversal of tax reserve. This impact was \$0.73 per share unfavorable during the third quarter this year and \$0.05 per share unfavorable for third quarter last year.

Moving next and I look at revenue by segment. During Q3, we experienced a 19% revenue decrease within the Auto/Mobile segment due to a significant year-over-year decline in ASPs as we competed against a very strong Q3 in 2009 when we refreshed our full line of PNDs.

Our Outdoor/Fitness segment continued to grow with a 9% revenue increase when compared to Q3 of '09 on the strength of our Fitness category. Aviation segment revenues increased 4% compared to Q3 2009 as we continue to certify additional aircraft platforms. Marine segment revenues

increased 1% Q3 – compared to Q3 '09 as our industry, Marine industry recovery faltered. And in total, our revenues decreased 11% during the third quarter. Year-to-date our revenues are down 2% with growth across all segments other than our Auto/Mobile business.

During Q3, North America and Europe declined, while Asia continued to post growth. Our North America business represents 60% of revenue in Q3 compared to 65% in the third quarter of '09. Europe increased from 30% to 31% of total business and Asia from 5% to 9% in the same time period.

The Auto/Mobile segment represented 64% of our total business during Q3 of 2010 down from 70% in 2009. Outdoor/Fitness grew to 21% of revenues in the quarter, a 4% increase from 2009.

Looking next at our operating income by segment. While the Auto/Mobile segment represented 64% of our total revenue during Q3, it represented only 40% of our operating income in the quarter due to the lower margin profile of this segment.

The operating income contribution of the Outdoor/Fitness, Marine and Aviation segments were 41%, 10% and 9% respectively. So in total, these segments contributed 60% of our Q3 operating income in 2010, and 62% of 2010 year-to-date operating income. We expect operating income to continue to be weighted toward our non-Auto/Mobile segments going forward.

Looking next at the margin results by segment; Q3 Auto/Mobile gross margin and operating margin were 41% and 15%, respectively. This was a significant decline to 2009 levels, when we had extremely high ASPs and margins associated with the full product refresh. Margins in the segment were also negatively impacted by the losses sustained in the mobile handset business. We do expect improved operating margins in the fourth quarter.

Q3 Outdoor/Fitness gross margin was 66%, up from 63% last year due to product mix. Operating margins remain very strong at 47% and increased from 40% in the year ago quarter due to the gross margin increased and improved leverage of our operating expenses.

Q3 Marine gross margin was 60% compared to 54% in the year ago quarter as product mix shifted toward our high-end chartplotters and networked Marine solutions. Operating margin in Marine was 34% up from 26% a year ago driven primarily by strong gross margin.

And finally, the Q3 Aviation gross margin remained at 70%, up from 67% in Q3 of '09. Operating margin was 27% for the quarter, up from 20% in the year ago quarter. The year-over-year improvement was primarily driven by one-time bad debt accrual in 2009 that did not repeat in 2010.

Focusing next on our operating expense results; Q3 operating expenses increased by \$4 million on a year-over-year basis from \$173 million to \$177 million this year, and increased 340 basis points as a percentage of sales. As I mentioned earlier, R&D increased \$13 million year-over-year in Q3, and was up 290 basis points to 10% of sales. We employ over 2,300 engineers and engineering associates worldwide, and remain committed to continued product innovation. Our advertising spending decreased \$5 million over the year ago quarter, and was flat as a percentage of sales at 5.9%. We will continue to manage advertising expense based on market dynamics in various segments. SG&A decreased \$4 million compared to the year ago quarter and increased by 50 basis points to 9.7% of sales. The decrease was driven by efforts to reduce costs as revenues have recently declined.

Looking next at the balance sheet, we ended the quarter with cash and marketable securities of nearly \$1.9 billion. Our accounts receivable increased to \$525 million, representing approximately 66 days of sales, which is down slightly from 71 days of sales in Q3 '09. Our inventory balances increased \$135 million to \$494 million as all categories of inventory grew. Our days of inventory metric was up to 140 days at the end of Q3 compared to 81 days at the end of Q3 '09.

The inventory buildup was largely driven by lower than expected sales in Q3. We've already taken steps to slow production levels and ensure that our working capital is maximized as we exit the year. We ended the quarter with the following number of days of inventory, \$128 million in raw materials, or 34 days, \$43 million in WIP, or 12 days, \$352 million in finished goods, or 94 days, and we ended the quarter with \$30 million in inventory reserves.

As you saw in the press release, we continued to generate strong cash flow across our business as cash from operations was \$204 million during Q3. We spent \$10 million on CapEx during Q3 and our free cash flow was \$195 million. Cash flow from investing used \$13 million of cash during the quarter which is made up of \$10 million in CapEx and \$4 million net purchase of marketable securities. Financing activities used \$138 million of cash during the quarter, which is primarily made up of stock repurchases throughout the period. And we earned an average of 1.2% on all cash and marketable securities during the third quarter.

Finally, I'd like to talk about use of cash and taxes. During Q3, we repurchased 4.3 million shares of common stock for approximately \$123.6 million. The repurchase plan of 300 million expires on – in December of 2011, and now has approximately \$77 million available for repurchase. We also continued to evaluate a number of acquisition opportunities across our various business segments.

In the third quarter, we reversed significant tax reserves recorded for 2006 to 2008 based on the completion of review by various tax authorities and the expiration of statute of limitations. This was a credit of \$114 million. The normalized effective tax rate in Q3 was 22%. The increase from 18% effective tax rate in the first half the year was driven primarily by unfavorable mix of income among our taxing jurisdictions. So excluding the one-time tax reversal, we expect our full-year tax rate to be approximately 20%.

This concludes our formal comments for the morning.

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