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## GRMN - Q1 2016 Garmin Ltd Earnings Call

EVENT DATE/TIME: APRIL 27, 2016 / 02:30PM GMT

**OVERVIEW:**

GRMN reported 1Q16 revenue of $624m, operating income of $104m and GAAP EPS of $0.46.

## CORPORATE PARTICIPANTS

**Teri Seck** *Garmin Ltd - Manager of IR*

**Cliff Pemble** *Garmin Ltd - President and CEO*

**Doug Boessen** *Garmin Ltd - CFO and Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Ben Bollin** *Cleveland Research Company - Analyst*

**Rich Valera** *Needham & Company - Analyst*

**Simona Jankowski** *Goldman Sachs - Analyst*

**Paul Coster** *JPMorgan - Analyst*

**Tavis McCourt** *Raymond James & Associates, Inc. - Analyst*

**Charlie Anderson** *Dougherty & Company - Analyst*

**Will Power** *Robert W. Baird & Co. - Analyst*

**Eugene Anderson** *Morgan Stanley - Analyst*

**Brad Erickson** *Pacific Crest Securities - Analyst*

## PRESENTATION

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### Operator

Good day, ladies and gentlemen, and welcome to the Garmin Ltd first-quarter 2016 earnings conference call.

(Operator Instructions)

As reminder today's program may be recorded.

I would now like to hand the program over to Teri Seck. Please go ahead.

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### Teri Seck - *Garmin Ltd - Manager of IR*

Good morning. We would like to welcome you to Garmin Limited's first-quarter 2016 earnings.

Please note that the earnings press release and related slides are available at Garmin's Investor Relations site on the internet at www.garmin.com/star. 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 Limited and its business. Any statements regarding our future financial positions, revenues, earnings, market shares, product introductions, future demand for our product, 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 filed with the Securities and Exchange Commission.

Presenting on behalf of Garmin Limited 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.

**Cliff Pemble** - ***Garmin Ltd - President and CEO***

Thanks, Teri, and good morning, everyone.

As announced earlier today, Garmin reported first-quarter consolidated revenue of $624 million, up 7% year-over-year. Our Fitness, Outdoor, Marine, and Aviation segments as a group grew 17% year-over-year, and contributed 69% of total revenues. Each of these segments have an exciting growth story which I will cover in a moment, as a result of the strategic investments we have been making in recent years to grow and diversify our business.

Gross margin was 54.5%, down year-over-year driven primarily by product mix. Operating margin declined to 16.6%, due to lower gross margin and an expense structure that was up slightly from the prior year. These factors combined with a higher year-over-year effective tax rate resulted in GAAP EPS and pro forma EPS in the quarter of $0.46 and $0.49, respectively.

We are maintaining the guidance issued earlier in the year, as our performance thus far is consistent with our expectations.

Next I'll provide a brief snapshot into the performance of each business segment.

Beginning with the Fitness segment, revenue grew 9% on a year-over-year basis, driven by strong growth of products with Garmin Elevate wrist heart rate technology. Running and activity tracker categories experienced robust growth over the prior year, somewhat offset by declines in the multisport category. Gross and operating margins were 51% and 12%, respectively. Gross margin was impacted by product mix shifting towards lower margin activity trackers, while operating margin was further impacted by ongoing investments in advertising and research and development.

As we've mentioned previously we believe these investments are strategically important in order to maximize the long-term opportunities in the Fitness market. While the margin profile of our Fitness segment has changed in recent quarters, we believe the performance will stabilize as we complete critical product and market transitions.

Our product lineup continues to grow, and I'm pleased to report that the vivoactive HR and the vivofit 3 are now shipping. I'm particularly excited about the vivoactive HR which adds Garmin Elevate wrist heart rate technology to our multi-activity GPS-enabled smart tracker. The vivofit 3 adds Move IQ Automatic activity detection, while carrying forward the strength that our vivofit family is already known for, such as industry-leading one-year battery life, and an always-on display.

With these additions, we have a strong lineup of products that offer something for every customer. To share this good news with the market, we have launched our spring Beat Yesterday advertising campaign across multiple media outlets. I encourage everyone to look for our Beat Yesterday creative material in train stations, airports, movie theaters, and of course on television.

Looking next at Outdoor, revenue increased 33% year-over-year, as we experienced strong demand for outdoor wearables and dog products. The Outdoor segment continued to generate strong growth and operating margins of 61% and 29%, respectively, and operating income grew 17% over the year ago quarter.

We recently launched several golf products, which have brought new excitement to the market. Additionally we have completed the acquisition of DeLorme, and look forward to integrating their technology into a broad range of product categories.

Looking next at Marine, revenue was up 29% over the prior year, driven by stronger sales of chart plotters and fish finders. Gross margin declined slightly in the quarter to 53%, due to product mix, while operating margin improved to 12%, as we successfully leveraged recent investments in the segment. Operating income grew 125% over the prior year. In recent years we've made significant investments in our Marine segment. As a result, our product line is extremely strong as we enter the 2016 Marine season.

Our recently launched GPSMap 8400 and 8600 are the largest plotters we've offered, and have strong differentiators that stand out in a highly competitive market. Another area of focus has been on improving our cartography offerings. We recently added depth contours to thousands of lakes in the USA and Canada, which will broaden our appeals in the inland fishing markets. We also added an exciting feature to our chartplotters that we call Quickdraw Contours, which enables users to create their own depth contours for small fishing lakes not covered by our HD maps.

Turning next to Aviation, revenue grew 8% over the prior year, as we experienced growth in both OEM and aftermarket product lines. Gross and operating margins remain strong at 74% and 29%, respectively, resulting in a 16% increase in operating income.

During the quarter, we expanded our reach into organizations that own and operate large fleets. Area ambulance provider Air Evac chose Garmin avionics for their fleet of Bell 206 and Bell 407 helicopters. And the United States Forest Service chose our G950 integrated cockpit system for their fleet of Sherpa aircraft that operate in the challenging role of fighting wildfires.

In recent years, we have mentioned the ADS-B opportunity, which is the transition to a more efficient next-generation air traffic management system. This mandated transition, which must be completed by the end of 2019, requires the installation of an ADS-B transponder in every aircraft operating in designated airspace.

Garmin has been early mover in the ADS-B market, and we recently expanded our product offerings with the introduction of the GTX 335 and 345 family of ADS-B transponders. These transponders feature an integrated dual-link transceiver, offering best available traffic awareness at a value price. We will continue to invest in ADS-B solutions in order to make this transition simple, beneficial, and cost-effective for a broad range of aircrafts and customers.

We continue to support our OEM partners in the development and certification of new aircraft and helicopter platforms. While industry dynamics remain a factor, market share gains and new platforms provide opportunities for future growth.

So looking finally at the Auto segment, revenues were down 11% for the quarter, primarily due to ongoing PND market contractions, and headwinds caused by additional revenue deferrals associated with auto OEM programs. Gross and operating margins were 44% and 9%, respectively.

During the quarter we began shipping our Drive family of PND devices, bringing driver assistance and awareness features to the aftermarket. Additionally we experienced strong growth in infotainment systems for the APAC region and also the Middle East. Finally, we delivered production software for the new 2017 Mercedes E class model.

We remain focused on disciplined execution in order to bring desired innovation to the market and to maximize profitability in this segment.

So that concludes my remarks for the morning. Next Doug will walk you through additional details on our financial results. Doug?

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**Doug Boessen** - ***Garmin Ltd - CFO and Treasurer***

Thanks, Cliff. Good morning, everyone.

I'd like to begin by reviewing our first-quarter results, then move to comments on the balance sheet and cash flow statement. We posted revenue of $624 million for the first quarter, representing a 7% increase year-over-year. Gross margin was 54.5%, a 430-basis point decrease from the prior year, driven by product mix. Operating expense grew 2% for $4 million, driven by increased spending in advertising and research and development. Operating income was $104 million. Operating margin was 16.6%, a decrease of 250 basis points from the prior year. This is a result of the decline in the gross margin rate.

Pro forma effective tax rate was 18.1% in the current quarter, compared to 12.3% in the prior year, due to projected income mix by jurisdiction. We still anticipate a full-year tax rate of approximately 20.5%. The first-quarter tax rate was positively impacted by the release of almost $4 million of tax reserves.

Our GAAP EPS was $0.46, and pro forma EPS was $0.49. We'll discuss gross margin operating expenses in more detail later.

Next, as we look at first-quarter revenue by segment, in the first quarter, we experienced growth in four of our five segments, led by robust double digit growth in our Outdoor and Marine segments, and high single digit growth in our Fitness and Aviation segments. Collectively, these four segments were up 17% compared to the prior-year quarter.

Looking at the first quarter revenue charts on this page, the Auto segment represented 31% of our total first-quarter 2016 revenue, compared to 38% in the first quarter 2015. Outdoor grew to 16% of revenue in the current period, compared to 12% in the prior year, while Marine grew from 11% to 13%, and Fitness grew from 22% to 23%.

As you can see, the charts illustrate our profitability mix by segment. Outdoor, Fitness, Marine, and Aviation collectively delivered 82% for operating income in the first-quarter of 2016. Fitness operating income as a percentage of the total operating income, decreased from 31% to 16%, while Aviation increased from 24% to 29%. Outdoor increased from 21% to 27%. And Marine increased from 4% to 10%.

Drilling down year-over-year gross margin by segment, aviation posted a gross margin rate increase, while Fitness, Outdoor, Auto, and Marine posted gross margin declines, due to shifts in product mix.

Total corporate operating margin decreased from 19.1% in the first quarter 2015 to 16.6% in the current quarter, due to gross margin pressure and increased advertising and R&D investments. These same factors contributed to the decrease in Fitness operating margin.

Looking next at operating expenses, as briefly mentioned, first-quarter operating expense increased by $4 million, or 2%. However, percentage of sales operating expense decreased from 39.7% in the first quarter 2015, to 37.8% in the current quarter.

Research and development increased $2 million year-over-year, a decline of 80 basis points to 17.3% of sales. We continue to invest in innovation, and increasing resources focused primarily on Aviation, Fitness, and Outdoor.

Our advertising expense increased $4 million for the prior quarter, representing 5.2% of sales, a 40-basis point increase. Additional spending was focused on Fitness investments in media.

SG&A was down $3 million compared to the prior quarter, decreasing 150 basis points percent of sales to 15.3%. The lower SG&A expense, which are driven primarily by a decrease in year-over-year litigation- related costs.

A few highlights on the balance sheet and cash flow statement, we ended the quarter with cash and marketable securities worth $2.3 billion. Accounts receivable decreased both sequentially and year-over-year to $408 million. Inventory balance increased year-over-year and sequentially to $518 million, as we grew our product offerings to prepare for a seasonally strong second-quarter.

During the first quarter 2016, we generated free cash flow of $115 million, compared to $64 million in the first quarter 2015. Also during the quarter we paid dividends of $97 million, repurchased about $20 million of company stock, with $140 million remaining to purchase through December 2016.

This concludes our full remarks. Jonathan, please open the line for Q&A.