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GRMN - Q2 2016 Garmin Ltd Earnings Call

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OVERVIEW:

GRMN reported 2Q16 operating income of $201m and GAAP EPS of $0.85. Expects 2016 revenue to be $2.9b.

CORPORATE PARTICIPANTS

Teri Seck *Garmin Ltd - Manager of IR*

Cliff Pemble *Garmin Ltd - President and CEO*

Doug Boessen *Garmin Ltd - CFO and Treasurer*

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PRESENTATION

Operator

Welcome to the second-quarter 2016 earnings conference call.

(Operator Instructions)

I would now like to introduce your host for today's conference, Teri Seck. Ma'am, you may begin.

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

Good morning. We would like to welcome you to Garmin Limited second quarter 2016 earnings call. 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/stock. An archive of the webcast and related transcripts 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***

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin reported second-quarter results highlighted by both revenue and EPS growth. Consolidated revenue increased 9% year over year. With fitness, outdoor, marine, and aviation collectively growing 20%, while contributing 70% of the total revenue in the quarter.

Each of our business segments produced strong results which I will highlight shortly. Gross margin expanded to 57% from 54.2% in the prior year, as new products and margin improvement efforts made a clear impact on our business.

Operating margin expanded to 24.7% from 21.5% in the prior year, and operating income grew 20% on a consolidated basis. The strong results generated $0.85 of GAAP EPS; pro forma EPS came in at $0.87, an increase of 21% over the year-ago quarter.

Wearable products were a major contributor to our strong second-quarter performance. Over the past year, we have expanded our wearable product portfolio with the goal of offering a wearable device for a wide range of active lifestyles.

As part of this effort, we have been pursuing two important objectives. First, we've been expanding the availability of Garmin Elevate wrist heart rate technology across our wearable product line. Garmin Elevate is now available in multiple models of our running products and our activity trackers and in our Fenix series of outdoor adventure watches.

Customers have embraced Garmin Elevate and the feedback we are receiving is very positive. The second important objective is to increase customer engagement by offering applications, widgets and watch faces to our Connect IQ app store.

Momentum in the app store continues to build, as we now offer over 2,000 apps, watch faces, and widgets and we have surpassed 13 million downloads from the store since the launch early last year. While I'm pleased with the progress we have made so far, there is certainly much more to do. We remain focused on a strong product roadmap, and building engagement through Connect IQ and our Garmin Connect community.

Looking now at segment highlights, our fitness segment experienced robust revenue growth of 34% on a year-over-year basis, driven by growth within all product categories. Gross margin came in at 56% and operating margin was 25%, an expansion of more than 400 basis points over the prior year.

This generated operating income growth of 60% in the quarter. Recent new product launches include the Forerunner 735XT a lightweight multi-sport running watch, and vivosmart HR+, which adds GPS capability to our smart activity tracker.

As a result of these and many other recent product releases, we estimate that our share of the GPS-enabled smart wearable market in the United States has grown from approximately 43% a year ago to approximately 57% today, according to market share data. During the quarter, we also introduced the vivomove, a fashionable analog watch, with activity tracking features and a one-year battery life.

Looking next to outdoor, which also experienced robust growth, revenue increased 23% year over year on strong demand for our outdoor wearables and a full quarter contribution of DeLorme sales. The outdoor segment generated strong gross and operating margins of 64% and 36%, respectively, representing an expansion over the prior year.

Operating income grew 31% over the year-ago quarter. One of the many benefits of our business model is the ability to share product platforms, technologies and components across multiple market segments. Recent examples include the Approach X40, a GPS-based activity tracker with Garmin Elevate wrist heart rate technology and a built-in database of over 40,000 golf courses, providing distance to the front, middle and back of the green.

We also introduced our next generation dog tracker, the Astro 430, which when paired to a DriveTrack 70 PND you can track up to 20 dogs from a vehicle. The Astro 430 can also pair with a Fenix 3 wearable for convenient tracking and alerts at the wrist.

Looking next at marine, revenue increased 8% over a very strong quarter in the prior year. Gross margin increased to 58% in the quarter, while operating margin expanded to 26%. Operating income grew 19% in the quarter.

Our new fish finders have been well received and we have grown our share in the inland fishing market. Earlier in the year, we introduced Quickdraw Contours, which enables boaters to create maps of their lakes with all processing and storage taking place right on the device.

We recently enhanced Quickdraw by offering a community feature called Quickdraw Community, which is a free cloud-based mapping platform for sharing user-generated HD mapping content. We believe QuickDraw Community will positively impact customer engagement and will expand the availability of HD mapping content, particularly on smaller fishing lakes.

Turning next to aviation, revenue grew 6% over the prior year, as we experienced growth in both OEM and ADS-B systems. Growth and operating margin remained strong, at 74% and 28%, respectively, resulting in a 13% increase in operating income. During the quarter, the G3000-equipped Piper M600 received type certification and we are pleased to be the avionics provider for this aircraft.

As we continue into the back half of 2016, we will focus on a number of additional certifications, including the aftermarket G5000 system for the Beechjet 400A and the Hawker 400XP. We announced several new products and product enhancements at the Oshkosh Airshow taking place this week.

Once such announcement is the Flight Stream 510, which is a multi-mode wireless radio system built into a multimedia card which also includes storage for a variety of flight databases. The Flight Stream 510 is important because it simplifies the task of updating flight databases by leveraging the connectivity of a smartphone or a tablet.

Flight Stream 510 also shares flight plans, traffic, weather and position information of the smartphones and tablets running our Garmin Pilot and mobile app. Fight stream 510 significantly enhanced the ability to incorporate consumer devices in the cockpit.

Looking finally at the auto segment, revenues were down 18% in the quarter primarily due to the ongoing PND market contraction, and headwinds caused by revenue deferrals associated with certain auto OEM programs. Gross margin came in at 46% and operating margin expanded to 16%.

We remain strategically focused on new opportunities in the auto OEM market. While we are typically thought of as a navigation and infotainment supplier, we are also leveraging our competencies in other technologies, such as cameras and driver assistance to expand our ability to serve the market.

At the recent 2016 Beijing Auto Show, Peugeot, showcased its model 3008, which includes a factory-installed Digital Video Recorder designed and manufactured by Garmin. In summary, we are pleased with our performance in the first half of 2016 and we believe we are well-positioned for the remainder of the year.

With this in mind, we are raising our projected revenue for the year to $2.9 billion, up approximately 3% over 2015. We are projecting gross margin of 55%, and operating margin of 19% for the full year. Factoring in an effective tax rate of approximately 19.5%, pro forma earnings per share is expected to be approximately $2.50.

Looking at our outlook by segment, we have increased growth expectations for fitness and outdoor to 20% for the year. Aviation and marine are unchanged while the outlook for auto has been reduced slightly based on current market trends. That concludes my remarks. Next, Doug will walk you through additional details on our financial results.

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

Thanks, Cliff. Good morning, everyone. I'd like to begin by reviewing our second quarter results and then move to comments on the balance sheet and cash flow statement. We posted revenue of $812 million for the second quarter, representing a 5% increase year over year.

Gross margin was 57% a 280 basis point increase from the prior year, driven primarily by segment and product mix. Operating expense as a percent of sales was 32.3%, a 40 basis point decrease from the prior year. Operating income was $201 million, a 20% increase with the prior year.

Operating margin was 24.7%, a 320 basis point increase from the prior year. The effective tax rate was 21% in the current quarter, which is comparable to effective tax rate of 20.6% in the prior-year quarter. Our GAAP EPS was $0.85, a 18% growth over the prior quarter; our pro forma EPS was $0.87, a 21% growth over the prior quarter.

We will discuss gross margin, operating expenses in more detail later. Next, we'll look at second quarter revenue by segment. During the second quarter, we had growth in four of our five segments, led by robust double-digit growth in our fitness and outdoor segments, and single-digit growth in our marine and aviation segments. Collectively these four segments were up 20% compared to the prior-year quarter.

Looking next at second quarter revenue charts, the auto segment represented 30% of our total second quarter 2016 revenue compared to 39% in the second quarter 2015. Fitness grew to 26% of revenue in the current period compared to 21% in the prior year, while outdoor grew from 14% to 17%.

As you see from the charts illustrate our profit mix by segment, outdoor, fitness, marine, and aviation, collectively, delivered 80% of operating income for the second quarter of 2016. Fitness operating income as a percentage of total operating income increased from 20% to 27%, and outdoor increased from 22% to 24%.

Looking at year-over-year gross margin by segment, all segments posted gross margin rate increase due to shifts in product mix. Total corporate operating margin increased from 21.5% to 24.7% due to gross margin improvement.

Looking next at operating expenses, second quarter operating expense increased by about $10 million, or 4%. Research and development increased $5 million year over year, and was flat as a percent of sales. We continue to invest in innovation and increasing resources, focused primarily on aviation, fitness and outdoor.

Our advertising expense decreased $1.5 million over the prior-year quarter, representing 5.5% of sales, a 50 basis point decrease. Additional advertising expense in fitness was more than offset by decreases in auto and marine. SG&A was up $6 million compared to the prior-year quarter, increasing 170 basis points, as a percent of sales to 12.8%. The increase in SG&A were driven primarily by expenses associated with the addition of the DeLorme business, and compensation-related costs.

A few highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with a cash and marketable securities of about $2.4 billion. Accounts receivable increased both sequentially and year over year/to $510 million. Inventory balance decreased sequentially to $508 million. As we exit the seasonally strong second quarter, it remains higher year over year due to new product offerings.

During the second quarter of 2016, we generated free cash flow of $135 million, a $71 million increase for the second quarter of 2015. Also during the quarter, we paid dividends of approximately $97 million, repurchased about $25 million of Company stock, approximately $123 million remaining for purchase through December 2016.

As Cliff mentioned, we are updating our tax guidance and now anticipate a full-year tax rate of approximately 19.5%. This completes our formal remarks. Jamie, could you open the lines for Q&A? Thanks.

Teri Seck - *Garmin Ltd - Manager of IR*

Thank you all for joining this morning. Doug and I will be available for call backs. Have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.