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GRMN - Q3 2016 Garmin Ltd Earnings Call

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**OVERVIEW:**

GRMN reported 3Q16 revenues of \$722m, operating income of \$160m, and GAAP EPS of \$0.66. Expects 2016 revenues to be \$2.95b and pro forma EPS to be approx. \$2.65.



## CORPORATE PARTICIPANTS

**Teri Seck** *Garmin Ltd. - IR*

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

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

## CONFERENCE CALL PARTICIPANTS

**Joe Wittine** *Longbow Research - Analyst*

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

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

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

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

**Jerry Liu** *Morgan Stanley - Analyst*

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

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

## PRESENTATION

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### Operator

Good day ladies and gentleman and welcome to your Garmin, third-quarter earnings call.

(Operator Instructions)

As are reminder, this conference is being recorded. I would now like to introduce your host for today's conference, Teri Seck. Ma'am, you may begin.

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### Teri Seck - *Garmin Ltd. - IR*

Good morning everyone. We would like to welcome you to Garmin Limited's third 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](http://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 Limited and its business. Any statements regarding our future financial position, revenues, earnings, market shares, product introductions, future demand for our products 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.

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

Thanks, Teri. And good morning everyone.



As announced earlier today, Garmin reported third quarter results highlighted by both revenue and EPS growth, with four of our five business segments delivering double digit sales growth and increased profitability. Consolidated revenue increased 6% year-over-year, with Fitness, Outdoor, Marine and Aviation collectively growing 24%, while contributing 70% of total revenue and 84% of total operating income in the quarter. Each of our business segments produced strong results, which I will highlight shortly.

Gross margin expanded to 56.2%, from 53.3% in the prior year, as sales shifted towards products with higher margin profiles. Operating margin expanded to 22.1% from 18.5% in the prior year and operating income grew 27% on a consolidated basis.

These strong results generated \$0.66 of GAAP EPS. Pro forma EPS came in at \$0.75, an increase 47% over the prior year. Wearable products were a major contributor to our strong third-quarter performance and we continue to expand into new product categories with the launch of the Vivofit Jr. and the Fenix Chronos.

Next I will highlight segment specific results and initiatives. Starting with Fitness, revenue increased 32% year over year led by strong demand for our wearables. Gross margin came in at 55% and operating margin was 24% and expansion of more than 500 basis points over the prior year. Operating income grew 68% in the quarter.

During the quarter we expanded our market with the launch of the Vivofit Jr. This activity tracker is designed specifically for kids with colorful one-piece bands that fit comfortably on a child's wrist. Vivofit Jr. shares many of the unique differentiators of our Vivofit line, such as an always on display, fully waterproof design and one-year battery life, while adding a compelling, parent-controlled mobile app that helps motivate kids to stay active.

We also launched the Forerunner 35, bringing Garmin elevate wrist heart rate technology, to our entry-level running product line. The Forerunner 35 features GPS, multiple activity profiles, smart alerts and a new high resolution display that is perfect for both indoor and outdoor use.

In the corporate health market, we recently announced a partnership with Cerner, a health information technology company. Through this partnership Garmin will provide devices that capture powerful health and wellness data that could be integrated into Cerner's Wellness and Population Health solutions.

Looking next at Outdoor, Revenue increased 28% year over year on strong demand for our Outdoor wearables and contributions from our recently acquired DeLorme subsidiary. The Outdoor segment generated strong growth in operating margins of 63% and 35%, respectively, and operating income grew 32% over the year-ago quarter.

We recently launched fenix Chronos, our first operating in the luxury watch category. The fenix Chronos line is crafted from premium jewelers' grade materials and is designed to look spectacular in business, social or personal setting without sacrificing the rugged multi-sport capabilities associated with our brand. We continue to invest in our traditional Outdoor product lines, as evidenced by the recent launch of the Rino 700 series, which features a three-inch multi-touch display and Bluetooth connectivity for real-time weather and position reporting.

Looking next at Marine, revenue increased 12% year over year, driven by growth in multiple product lines and led by strong demand for our fish finders. Gross margin increased to 57% in the quarter, while operating margin expanded to 15%. Operating income grew 80% in the quarter.

For the second consecutive year, we were recognized by the National Marine Electronics Association as Manufacturer of the Year. This award, along with seven Product of Excellence awards, confirms our dedication to designing, manufacturing and selling industry-leading products for the marine market. In addition, at the International Boatbuilders' Exhibition, we received an innovation award for our recently launched Fantom solid-state radar.

Turning next to Aviation. Revenue grew 14% over the prior year, as we experienced growth in both OEM and aftermarket product categories. Gross and operating margins remained strong at 75% and 28%, respectively, resulting in a 28% increase in operating income. During the quarter, we received certification of the G5000-equipped Beechjet 400A and we began deliveries of this system to installers.

We announced earlier this week that we were developing a G5000 integrated flight deck upgrade for the Citation Excel and the XLS. This upgrade will feature three high-resolution displays, a modern fully-digital flight control system, and enhanced safety features. We expect to receive certification of this system in late 2018.

Looking finally at the Auto segment, revenues were down 21% 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 44% and operating margin was consistent year over year at 12%. While the PND market continues to decline, our global market share remains strong.

During the quarter, we launched our latest action camera, the VIRB Ultra 30. This new action camera takes pictures at 30 frames per second. The VIRB Ultra 30 also includes first-to-market features, such as voice control, color LCD with touchscreen, one touch live streaming, and our geometric sensors.



Finally, with three quarters of the year behind us, we are raising our projected revenue for the year to \$2.95 billion, up approximately 5% over 2015. We are projecting gross margin of approximately 55% and operating income of approximately \$580 million for the year. Factoring in an effective tax rate of approximately 18.5%, pro forma earnings per share is expected to be approximately \$2.65.

Looking at our guidance by segment, we have increased year-over-year growth expectations by roughly 200 basis points to 400 basis points for all segments except auto, where we are holding our guidance of down 17% for the year. That concludes my remarks.

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.

Let's begin by reviewing our third-quarter results and move to comments on the balance sheet and cash flow statement. We posted revenue of \$722 million for the third quarter, representing a 6% increase year over year. Gross margin was 56.2%, featuring a 90-basis point increase from the prior year.

Operating expense percentage of sales was 34.1%, a 70-basis point decrease from the prior year. Operating income was \$160 million, a 28% increase over the prior year. Operating margin was 22.1%, a 360 basis point increase from the prior year.

Our GAAP EPS was \$0.66, a 6% growth over the prior quarter. Our pro forma EPS was \$0.75, a 47% growth over the prior quarter. We will discuss gross margin and Operating expenses in more detail later.

Next we will look at third-quarter revenue by segment. In the third quarter, we achieved double digit growth in four of five segments, led by robust growth in our Fitness and Outdoor segments, and solid growth in Marine and Aviation segments. Collectively, these four segments were up 24% compared to the prior-year quarter.

Looking next to third-quarter revenue charts, the Auto segment represented 30% of our total 2016 revenue compared to 40% in third-quarter 2015. Fitness, we did 26% of revenue in the current period compared to 21% in the prior year, where Outdoor grew 19% from 16%.

You can see on the charts illustrate our profit mix by segment. Outdoor, Fitness, Marine, and Aviation collectively delivered 84% of operating income in third-quarter 2016. Fitness operating income, as a percentage of total operating income, increased from 21% to 28%, and Outdoor increased from 29% to 31%.

Looking at year-over-year gross margin by segment. All segments posted a gross margin rate increase, as increased sales shifted to our products with higher-margin profiles. Total corporate operating margin increased from 18.5% to 22.1%, primarily due to gross margin improvement.

Looking next at operating expenses, third quarter operating expense increased by approximately \$9 million, or 4%. Research and development increased \$10 million year over year, but 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 \$4 million compared to the prior-year quarter, and represented 4.6% of sales, a 90-basis point decrease. The decrease in advertising was primarily in auto. We expect our fourth-quarter advertising spend to increase both sequentially and year-over-year to support our wearable products.

SG&A was up \$3 million compared to the prior-year quarter, however, decreased 40 basis points due to percent of sales, 13.4%. The increase in SG&A was driven primarily by expenses associated with the addition of the DeLorme business.

A few highlights on the balance sheet, cash flow statement, and taxes. We ended the quarter with cash and marketable securities over \$2.4 billion. Accounts receivable decreased sequentially as a result of seasonably lower sales in the third quarter, but increased year over year to \$461 million from stronger sales.

Inventory balance increased sequentially to \$535 million to prepare for the fourth quarter and remains higher year over year via new product offerings. For the third quarter of 2016, we generated free cash flow of \$199 million, a \$75 million increase for the third quarter of 2015. Also during the quarter, we paid dividends of approximately \$96 million and purchased approximately \$20 million of Company stock.

We have roughly \$103 million remaining in the share repurchase program that is authorized through December 31, 2016. We expect to repurchase as business and market conditions warrant. Effective tax rate is 16.5% in the current quarter compared to 37.7% in the prior quarter.



The decrease in effective tax rate is primarily due to projected income mix by jurisdiction compared to prior year. These concludes our formal remarks. Esther, can you please open the line for Q&A?

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**Teri Seck - *Garmin Ltd. - IR***

Thanks, everyone. Doug and I will be available for call back. Have a great day. Bye.

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**Operator**

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

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