THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

GRMN - Q1 2017 Garmin Ltd Earnings Call

EVENT DATE/TIME: MAY 03, 2017 / 02:30PM GMT

OVERVIEW:

Co. reported 1Q17 consolidated revenue of $639m, operating income of $116m and GAAP EPS of $1.26.

THOMSON REUTERS

CORPORATE PARTICIPANTS

Clifton Albert Pemble *Garmin Ltd. - CEO, President, Director, President of Garmin International Inc, President of Garmin USA Inc and President of Garmin AT Inc*

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

Teri Seck

CONFERENCE CALL PARTICIPANTS

Benjamin James Bollin *Cleveland Research Company - Senior Research Analyst*

Bradley D. Erickson *Pacific Crest Securities, Inc., Research Division - Research Analyst, Marketplaces and Lifestyle*

Charles L. Anderson *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst*

Joseph Helmut Wittine *Longbow Research LLC - Research Analyst*

Paul Coster *JP Morgan Chase & Co, Research Division - Senior Analyst, Alternative Energy, and Applied and Emerging Technologies*

Richard Frank Valera *Needham & Company, LLC, Research Division - Senior Analyst of Communications Infrastructure, Technical Software and Communications Services*

Simona Kiritsov Jankowski *Goldman Sachs Group Inc., Research Division - MD and Senior Equity Research Analyst*

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

Yuuji P. Anderson *Morgan Stanley, Research Division - Research Associate*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Garmin First Quarter 2017 Earnings Conference Call. (Operator Instructions) I would now like to introduce your host for today's conference, Teri Seck, Investor Relations. Please go ahead, ma'am.

Teri Seck

Good morning. We would like to welcome you to Garmin Ltd.'s First Quarter 2017 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 Ltd. and its business. Any statements regarding our future financial position, revenues, earnings, growth and operating margins and 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 the 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 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. - CEO, President, Director, President of Garmin International Inc, President of Garmin USA Inc and President of Garmin AT Inc*

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin recorded first quarter consolidated revenue of $639 million, up 2% over the prior year. Marine, outdoor, aviation and fitness collectively increased 12% year-over-year and contributed 75% of total revenues. Gross margin improved to 58.3% as both segment and product mix were favorable. As a result of our increased revenues and gross margins, our operating margin improved to 18.2%, while operating income increased 12%. This resulted in GAAP EPS of $1.26, which includes a significant income tax benefit recognized during the quarter. Pro forma EPS, which excludes this benefit, grew 7% to $0.52 in the quarter.

We are pleased with our first quarter results, which delivered growth in revenue, profits and earnings. However, since Q1 represents the lowest seasonal quarter of our financial year, we are maintaining the guidance issued in February. Doug will discuss our financial results in greater detail in a few minutes, but first, I'd like to provide a few brief remarks on the performance of each business segment.

Starting with marine. Revenue grew 26%, ahead of the overall market, resulting in market share gains. All major product categories performed well. Gross margin improved to 57%, while operating margin improved to 17%, resulting in operating income growth of 76% over the prior year. Marine season is in full swing, and we have seen strong demand for our latest product offerings. We started shipping our new GPSMAP chartplotters early in the season, and the feedback from customers has been very positive. Looking forward, we remain focused on gaining market share through innovations that will clearly differentiate us in the market.

Looking next at outdoor. Revenue increased 20% on strong demand for outdoor wearables. The segment continued to generate strong gross margin and operating margin of 63% and 30%, respectively, while operating income grew 24% over the prior year. We began shipping the highly anticipated fenix 5 adventure watch series late in the quarter. Orders have been very strong, and we expect that it will take several weeks to catch up with demand.

We also recently hosted our first Connect IQ Developer Summit, bringing together application developers and business partners to participate in hands-on workshops and breakout sessions with our product managers and engineers. At the event, we announced new capabilities for Connect IQ, including the ability for app developers to implement a revenue model. We also announced new integration partners, including SmartThings, which gives us a strong presence in the emerging home automation market.

Turning next to aviation. We reported solid revenue growth of 16%, driven by growth in aftermarket products and led by strong growth related to our ADS-B offerings. Gross and operating margin remained strong at 74% and 31%, respectively, resulting in operating income growth of 27% over the prior year. During the quarter, we started shipments of the G1000 NXi, the next-generation integrated flight deck featuring wireless connectivity and enhanced safety features. We received European certification for the GTX 345, expanding the addressable market for this popular ADS-B transponder.

In addition, we continue to support our OEM partners in the development and certification of new aircraft and helicopter platforms. Much has been said about the challenging market conditions, which remain a factor. However, we continue to believe that market share gains and new platforms provide opportunities for long-term growth.

Looking next at fitness. Revenue declined 3%, driven by the rapidly maturing market for basic activity trackers, especially those which lack GPS capability. Despite this challenge, we are very pleased with the performance of advanced wearables with GPS capability, which experienced robust growth during the quarter and nearly offset the steep decline of basic activity trackers. Gross margin increased to 56% as product mix shifted to the higher-margin devices. Operating margin increased to 13%, resulting in operating income growth of 11%. During the quarter, we launched the Forerunner 935, which is our most advanced multisport watch with new running dynamics features and enhanced performance and recovery monitoring. We also introduced our latest vivosmart 3, an ultra-slim smart activity tracker with wrist-based heart rate and an innovative stress tracking feature. While we continue to see the market for basic activity trackers mature, we also see growth opportunities in advanced wearables with GPS, and we are confident in our product roadmap going forward.

Looking finally at the auto segment. Revenues were down 19% in the quarter due to the ongoing decline of the PND market and partially offset by growth in our auto OEM product lines. Gross margin was 44%, which is consistent year-over-year, while operating margin declined to 4%. During the quarter, we began shipping our next-generation Drive family of PND devices, which adds wireless connectivity and enhanced driver alerts. We also introduced the Dash Cam 45 and 55, offering high-quality recording in an ultracompact form factor. We remain focused on disciplined execution to bring desired innovation to the market and to maximize profitability in the segment.

Okay. Finally, before turning the call over to Doug, I wanted to mention the recognition we recently received from Forbes Magazine, ranking us among the top 100 most reputable companies in America. Our employees work very hard to make Garmin the best at everything we do and to operate the business with integrity. It's a special honor for all of us to be recognized in this way.

So that concludes my remarks. Next, Doug will walk you through additional details of our financial results.

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

Thanks, Cliff. Good morning, everyone. Let me begin by reviewing our first quarter financial results and move to comments on the balance sheet, cash flow statement and taxes.

We posted revenue of $639 million for the first quarter, representing a 2% increase year-over-year. Gross margin was 58.3%, a 380 basis point increase from the prior year, driven by the shift towards segments with higher margin as well as product mix within certain segments. Operating expense as a percentage of sales was 40.1%, a 230 basis point increase from the prior year. Operating income was $116 million, a 12% increase year-over-year. Operating margin was 18.2%, a 160 basis point increase from the prior year as the increase in gross margin more than offset the increase in operating expenses. Our GAAP EPS was $1.26, which includes a $169 million income tax benefit due to revaluation of certain Switzerland deferred tax assets. And pro forma EPS was $0.52, a 7% increase from the prior year.

Next, we'll look at our first quarter revenue by segment. In the first quarter, we achieved 2% consolidated growth, led by double-digit growth in 3 of our 5 segments. Collectively, marine, outdoor, aviation and fitness were up 12% compared to the prior year quarter.

Looking next at the first quarter revenue charts. Collectively, the marine, outdoor, aviation and fitness segments contributed 75% total revenue in the first quarter of 2017 compared to 69% in the prior quarter. Marine grew from 13% to 16%, while aviation grew from 17% to 19%, and outdoor grew from 16% to 18%. As you can see, the charts illustrate the profit mix by segment. Marine, outdoor, aviation, fitness segments collectively delivered 94% of operating income in the first quarter of 2017 compared to 82% first quarter of 2016. Marine, outdoor, aviation, fitness segments had a year-over-year increase in both operating income dollars and operating margin.

Looking next at our operating expenses. First quarter operating expenses increased by $20 million or 8%. Research and development increased $14 million year-over-year or 180 basis points to 19.1% of sales. We continue to invest in innovation, increasing resources focused primarily on aviation, fitness, outdoor and marine, where we see long-term growth opportunities. SG&A was up $6 million compared to prior year quarter and increased 70 basis points as a percent of sales to 16%. Increased spending in SG&A was primarily driven by increased legal-related expenses and information technology costs. Advertising expense was relatively flat compared to prior year quarter, representing 4.9% of sales.

A few highlights on the balance sheet and cash flow statement. We ended the quarter with cash and marketable securities of approximately $2.3 billion. Accounts receivable decreased, as expected, both sequentially and year-over-year to $391 million. Our inventory balance increased over the prior year sequentially to $533 million as we prepare for the seasonally strong second quarter. In the first quarter of 2017, we generated free cash flow of $95 million, a $21 million decrease from the prior year quarter. Also during the quarter, we paid dividends of $96 million and purchased $28 million of company stock, with $47 million remaining to purchase through December 2017.

In the first quarter of 2017, we reported income tax benefit of $150 million, which includes a $169 million income tax benefit due to revaluation of certain Switzerland deferred taxed assets. Excluding the $169 million income tax benefit, first quarter 2017 pro forma effective tax rate was 21.3% compared to 18.1% in the prior year quarter. The 320 basis point year-over-year increase in the pro forma effective tax rate is primarily due to the company's election to align certain Switzerland tax positions with international tax initiatives. We continue to expect our full year 2017 pro forma effective tax rate to be approximately 22%.

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

Operator

And that concludes our Q&A session for today. I'd like to turn the call back over to Teri Seck for any further remarks.

Teri Seck

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

Operator

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