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GRMN - Q2 2017 Garmin Ltd Earnings Call

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OVERVIEW:

Co. reported 2Q17 revenues of $817m and GAAP EPS of $0.91. Expects 2017 revenues to be $3.04b and pro forma EPS to be approx. $2.80.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Garmin Ltd. Second Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded. I would now like to turn the conference over to Teri Seck. Ma'am, you may begin.

Teri Seck

Good morning. We would like to welcome you to Garmin Ltd. Second 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, gross 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 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

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin reported second quarter consolidated revenue of $817 million, up 1% over the prior year. Outdoor, aviation, marine and fitness collectively increased 8% year-over-year and contributed 74% of total revenues. Gross margin improved to 58.5% compared to the prior year due to favorable segment revenue mix. As a result of our increased (inaudible) and gross margins, our operating margin improved to 24.9%. This resulted in GAAP EPS of $0.91 and pro forma EPS of $0.88 in the quarter.

Our results were positively impacted by growth in advanced wearables. Our Connect IQ app store is the direct reflection of end-user engagement with our wearables. During the past 12 months, there have been over 17 million downloads of an app, watch face or data field from our Connect IQ store, and the total downloads increased to over 30 million since inception.

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. Beginning with the outdoor segment. Revenue grew 46% on a year-over-year basis, driven by strong growth of our fenix line of smart watches. Gross and operating margins expanded to 66% and 38%, respectively, while operating income grew 53% over the prior year. We experienced strong demand for the fenix 5 watch series and anticipate it will continue to have a positive impact on our outdoor segment for the remainder of the year. In addition, we continue to see solid growth of our new inReach devices and subscription-based services. Finally, we launched the Approach S60, a premium watch for the golf enthusiasts, and we recently announced the newest members of our Foretrex and Rino product lines. Looking forward, we are focused on opportunities in wearables and inReach.

Turning next to aviation. We reported strong revenue growth of 15%, driven by growth in aftermarket products. We also experienced positive contributions from our OEM product categories. Gross and operating margins remain strong at 75% and 32%, respectively, resulting in operating income growth of 28% over the prior year.

During the quarter, we introduced our first head-up display, which was designed specifically for aircraft with integrated flight decks. We are pleased that the Cessna Citation Longitude will be the launch platform for this new product category. We also received European approval for our G1000 NXi system, expanding the reach of this aftermarket offering for King Air 200, 300 and 350 aircraft models. Looking forward, we are focused on maximizing ADS-B mandate opportunities and gaining share in the OEM market.

Looking next at marine. Revenue declined 3%. However, this segment is performing as expected on a year-to-date basis with 10% revenue growth. We believe that favorable weather earlier in the year accelerated buying, which impacted the results of the second quarter. Gross and operating margins were 57% and 22%, respectively. During the quarter, we completed the acquisition of Active Captain, the developer of crowd-sourced content for boaters. In addition, we launched our next-generation quatix wearable. Looking forward, we are focused on product innovations and gaining share in the inland fishing category.

Looking next at fitness. Revenue declined 15%, driven by the rapidly maturing market for basic activity trackers and the timing of new product introductions. Gross margin was steady at 56%, while operating margin decreased year-over-year to 21%. While the quarter has been challenging for fitness, we remain positive about the opportunities in this segment. We expect these trends to continue into Q3. However, we anticipate ending the year on a stronger note as our product refresh cycle is completed. Looking forward, we are focused on areas of opportunity, particularly in the advanced wearable category.

Looking finally at the auto segment. Revenues were down 15% due to the ongoing decline of the PND market, partially offset by growth in several niche categories such as fleets, cameras and RVs. Gross and operating margins declined year-over-year to 45% and 13%, respectively. Our global market share position in the PND category remains very strong. During the quarter, we launched the VIRB 360, a compact, full spherical, immersive camera built for adventure. VIRB 360 is an amazing device that captures video up to 5K/30 frames per second and makes it easy to share memories on the go. Looking forward, we are focused on disciplined execution to bring desired innovation to the market and to maximize profitability in the segment.

Turning finally to guidance. We are pleased with our consolidated performance in the first half of 2017 and believe we are well positioned for the remainder of the year. As a result, we are raising our projected revenue for the year to $3.04 billion, up about 1% over 2016. We project gross margin to increase to approximately 57.5% due to segment mix, and we project operating margin of approximately 21% for the full year. Assuming a pro forma effective tax rate of approximately 22%, pro forma earnings per share is expected to be approximately $2.80.

Looking at our annual revenue outlook by segment. We have increased our growth expectations for the outdoor segment to 25% and the aviation segment to 10%. Marine and auto are unchanged, while the outlook for fitness has been revised to down 5% due to the continued decline in activity tracker category.

That concludes my remarks. Next, Doug will walk you through additional details on our financial results. Doug?

Douglas Gerard Boessen - Garmin Ltd. - CFO and Treasurer

Thanks, Cliff. Good morning, everyone. I'll begin by reviewing our second quarter financial results and move to comments on the balance sheet, cash flow statement and taxes.

We posted revenue of $817 million for the second quarter, representing 1% increase year-over-year. Gross margin was 58.5%, a 150 basis point increase from the prior year, driven by the shift towards segments with higher margin. Operating expense as a percentage of sales is 33.6%, a 130 basis point increase from the prior year. Operating income was $203 million, a 1% increase year-over-year. Operating margin was 24.9%, a 20 basis point increase from the prior year. The increase in gross margin more than offset the increase in operating expenses. Our GAAP EPS was $0.91. Pro forma EPS was $0.88, a 1% increase from the prior year.

Next, we'll look at our second quarter revenue by segment. During the quarter, we achieved 1% consolidated growth, led by double-digit growth in our outdoor and aviation segments. This growth was partially offset by the decline in fitness segment, a result of the significant decline in activity tracker category and continued decline in the auto PND business. Collectively, outdoor, aviation, marine and fitness were up 8% compared to prior year quarter.

Looking next at second quarter revenue and operating income. Collectively, outdoor, aviation, marine and fitness segments contributed 74% of total revenue in the second quarter of 2017 compared to 70% in prior year quarter. Outdoor grew from 17% to 24%, and aviation grew from 13% to 15%. As you can see from the charts illustrating our profit mix by segment, the outdoor, aviation, marine and fitness segments collectively delivered 86% of operating income in the second quarter of 2017 compared to 80% in second quarter of 2016. The outdoor and aviation segments had a year-over-year increase in both operating income dollars and operating margin.

Looking next at operating expenses. The second quarter operating expenses increased by $12 million or 5%. Research and development increased $13 million year-over-year or 150 basis points to 15.6% of sales. We continue to invest in innovation, increasing resources focused on fitness, outdoor, marine, aviation, segments where we see long-term growth opportunities. SG&A was up $1 million compared to prior year quarter but relatively flat as a percent of sales. Our advertising expense was $2 million less than the prior year quarter. Traditional spend in outdoor segment was more than offset by decreases in the fitness and all the segments.

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 increased sequentially year-over-year to $515 million. Our inventory balance decreased sequentially to $525 million as we exit the seasonally strong second quarter. During the second quarter of 2017, we generated free cash flow of $129 million, a $6 million decrease from the prior year quarter. Also during the quarter, we paid dividends of $96 million and purchased $36 million of company stock, $11 million remaining for purchase through December 2017.

In the second quarter of 2017, we reported an effective tax rate of 25%, which includes $7 million of income tax expense resulting from a new accounting standard related to the expiration of share-based awards. Excluding the $7 million of income tax expense, second quarter 2017 pro forma effective tax rate was 21.9% compared to 21% in the prior year quarter. The 90 basis point year-over-year increase in pro forma effective tax rate is primarily due to the company's election to align certain Switzerland corporate tax positions with international tax initiatives, partially offset by income mix by tax jurisdiction. We continue to expect our full year 2017 pro forma effective tax rate to be approximately 22%.

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