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GRMN - Q3 2017 Garmin Ltd Earnings Call

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OVERVIEW:

Co. reported 3Q17 revenues of $743m and GAAP EPS of $0.78. Expects 2017 revenue to be $3.07b and pro forma EPS to be approx. $2.90.

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Garmin Ltd. Third Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host today, Teri Seck. You may begin.

Teri Seck

Good morning. We would like to welcome you to Garmin Ltd. Third 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 transcript 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

Thanks, Teri, and good morning, everyone. As announced earlier today, Garmin reported third quarter consolidated revenue of $743 million, up 3% over the prior year. Outdoor, aviation, marine and fitness collectively increased 9% year-over-year and contributed 75% of total revenues. Gross margin improved to 58.4%, and operating margin improved to 22.8%. GAAP EPS was $0.78, and pro forma EPS was $0.75 in the quarter. Doug will discuss our financial results in greater detail in a few minutes, but first, I'd like to make a few brief remarks on the performance of each business segment.

Beginning with the outdoor segment. Revenue grew 31% on a year-over-year basis, driven by strong demand for wearables. Gross and operating margins expanded to 64% and 37%, respectively, while operating income grew 38% over the prior year. We experienced strong demand for the fenix 5 watch series and expect this trend to continue throughout the holiday quarter.

In addition, we experienced solid growth of inReach devices and subscription services. We recently announced our entry into 2 new product categories with the introduction of Descent, our first wearable for the dive market, and the Impact bat sensor, our first product for the baseball market.

The Descent is a beautifully designed smart watch with integrated dive computer functions and electronic logs managed through Garmin Connect. The Impact bat sensor delivers instantaneous feedback on the device while coaches and players can see further details using the Impact mobile app. Looking forward, we remain focused on the wearable opportunity and expanding into new product categories.

Turning next to aviation. We reported strong revenue growth of 16%, driven by growth in both OEM and aftermarket categories. Gross and operating margins came in at 73% and 27%, respectively, resulting in operating income growth of 12% over the prior year. We recently announced the TXi series of touchscreen flight displays that offer enhanced integration features and target a broad range of aftermarket aircraft from light signals -singles to business jets.

We also started shipping the GFC 600, our first aftermarket autopilot solution. These new products are welcome additions to our lineup and further expand addressable market opportunities. Looking forward, we are focused on maximizing ADS-B mandate opportunities and gaining share in the OEM market.

Looking next at marine. Revenue increased 10% year-over-year, driven by growth in multiple product lines and led by strong demand for our fishfinders and chartplotter combos. Gross and operating margins were 58% and 24%, respectively. We recently completed the acquisition of Navionics, a leading worldwide provider of electronic marine content and mobile applications. Combining content from both Navionics and Garmin will result in best available breadth and depth of coverage for our marine customers.

For the third consecutive year, we were recognized by the National Marine Electronics Association as Manufacturer of the Year. This award, along with 8 product of excellence awards, affirms our commitment to designing, manufacturing and selling industry-leading products for the marine market. Consistent with that commitment, we announced the 2018 lineup of marine electronics, which include updated echoMAP and STRIKER models with WiFi capability, enabling connected boating experiences. Looking forward, we are focused on product innovations and gaining share in the inland fishing category.

Moving next to fitness. Revenue declined 12%, driven by the rapidly maturing market for basic activity trackers and product introduction timing, partially offset by strong growth in our running product line. Gross margin improved to 58%, while operating margin decreased year-over-year to 20%. Our product lineup is very strong as we enter the holiday quarter.

Recent product launches include the vívoactive 3 with wrist-based payments, the vívomove HR analog watch with wrist heart rate and smart notifications and the ultraslim vívosport activity tracker with built-in GPS and smart notifications. In addition, we launched our vívofit jr. 2, featuring Disney, Star Wars and Marvel team bands and mobile app adventures. Looking forward, we're focused on areas of opportunity, particularly in the advanced wearable category.

Looking finally at the auto segment. Revenue declined 12% due to the ongoing PND market contraction, partially offset by solid growth in OEM and niche product categories such as cameras, truck fleet and RV. Our global market share in the PND category remains very strong. Gross and operating margins declined year-over-year to 44% and 8%, respectively.

We recently launched Garmin Speak with Amazon Alexa, which is the first digital assistant with integrated turn-by-turn navigation. We also started shipping the eLog device in time for the upcoming electronic data logging mandate for truck operators. Looking forward, we are focused on disciplined execution to bring desired innovation to the market and to optimize profitability in the segment.

Well, with 3 quarters of the year behind us, we're updating our projected revenue for the year to $3.07 billion, an increase of about 2% over 2016. Projected gross margin remains at approximately 57.5%, but we are raising our projected operating margin to approximately 21.5% for the full year. Pro forma earnings per share is expected to be approximately $2.90, assuming an updated pro forma effective tax rate of approximately 21.5%.

Looking at guidance by segment. We've increased growth expectations for outdoor, aviation and auto by 200 to 300 basis points. Our outlook for marine is unchanged, while the outlook for fitness has been reduced slightly by 200 basis points.

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

Douglas Gerard Boessen - Garmin Ltd. - CFO and Treasurer

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

We posted revenue of $743 million for the third quarter, representing a 3% increase year-over-year. Gross margin was 58.4%, 220 basis point increase from the prior year, driven primarily by segment and product mix. Operating expense as percentage of sales was 35.5%, a 140 basis point increase from the prior year. Operating income was $170 million, a 6% increase year-over-year. Operating margin was 22.8%, a 70 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 $0.78. Our pro forma EPS was $0.75, consistent with the prior year.

Next we'll look at our third quarter revenue by segment. During the quarter, we achieved 3% consolidated growth, led by double-digit growth in 3 of our 5 segments. For the third quarter 2017, outdoor grew 31%, while aviation grew 16% and marine grew 10%. This growth was partially offset by the continued decline in the auto PND business and decline in our fitness segment, which was primarily due to significant decline in the basic activity tracker category. Collectively, outdoor, aviation, marine and fitness were up 9% compared to the prior year quarter.

Looking next at third quarter revenue and operating income. Collectively, the outdoor, aviation, marine and fitness segments contributed 75% of total revenue in the third quarter 2017 compared to 70% in the prior year quarter. Outdoor grew from 19% to 25%, and aviation grew from 15% to 17%. You can see from the charts, illustrating our profit mix by segment, the outdoor, aviation, marine and fitness segments collectively delivered 91% of operating income in the third quarter 2017 compared to 84% in the third quarter 2016.

Looking next at operating expenses. Our third quarter operating expenses increased by $18 million or 7%. Research and development increased to $130 million or 17.4% of sales, a 130 basis point increase year-over-year. We continue to invest in innovation, increasing resources focused on our fitness, outdoor, marine and aviation segments where we see long-term growth opportunities.

SG&A was up $5 million compared to prior year quarter, increased 30 basis points as a percent of sales to 13.7%. Our advertising expense was relatively flat to the prior year quarter as additional spend in the outdoor segment was offset by decreases in all the other segments.

Few highlights on the balance sheet and cash flow statement. We ended the quarter with cash and marketable securities of approximately $2.4 billion. Accounts receivable decreased sequentially to $457 million, relatively flat year-over-year. Inventory balance increased sequentially to $575 million to prepare for the fourth quarter and was higher year-over-year due to several new product launches at the end of third quarter 2017.

During the third quarter 2017, we generated free cash flow of $153 million. Also during the quarter, we paid dividends of $96 million and purchased approximately $11 million of company stock, about $1 million remaining for purchase through December 2017.

The effective tax rate was 20.8% at current-year quarter compared to 16.5% in the prior year quarter. The increase in effective tax rate was primarily due to the company's election to align certain Switzerland corporate tax positions with international tax initiatives and income mix by tax jurisdiction, partially offset by the release of income tax reserves in the third quarter 2017. We expect our full year 2017 pro forma effective tax rate to approximately 21.5%.

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

Teri Seck

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

Operator

This concludes today's conference call. You may now disconnect.