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Q1 2018 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Garmin's First Quarter 2018 Earnings Conference Call. (Operator Instructions)

I'd now like to turn the conference over to Teri Seck. Please go ahead.

Teri Seck -

Good morning. We would like to welcome you to Garmin Ltd. First Quarter 2018 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.

As a reminder, we adopted the new U.S. GAAP revenue standard in the first quarter of 2018. The prior periods presented here have been restated to reflect adoption of this new standard.

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. - President, CEO, Principal Operating Officer & Director*

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin recorded revenue for the first quarter of 2018 with double-digit growth in revenue, profit and EPS. Consolidated revenue came in at \$711 million, up 11% over the prior year. Outdoor, fitness, aviation and marine collectively increased 18% year-over-year and contributed 80% of total revenues.

Gross margin improved year-over-year to 60% due to segment and product mix. Operating margin improved to 20%, while operating income increased 22%. This resulted in GAAP and pro forma EPS of \$0.68, with pro forma EPS growth of 31% over the prior year.

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

Starting with outdoor. Revenue increased 24% on strong demand for outdoor wearables. The segment generated strong gross and operating margins of 65% and 30%, respectively, while operating income grew 27% over the prior year.

During the quarter, we began shipping the Descent dive watch. Descent brings innovation to the dive computer market by combining smartwatch utility with dive computer functions for the underwater adventurer. Descent has been well received, and we are excited for the opportunities we have in this new product category. Also, we recently announced the tactix Charlie, a tactical-themed smartwatch with unique features such as night vision compatibility and Jumpmaster mode for skydivers.

Looking next to fitness. Revenue increased 20%, driven primarily by growth in the advanced wearable category. Gross margin improved to 58% due to product mix. Operating income improved to 20%, resulting in operating income growth of 81%.

During the quarter, we began shipping the Forerunner 645M, our first GPS running watch with

integrated music and mobile payments. We recently announced several new cycling products, including the Edge 130 and the Edge 520 Plus. The Edge 130 is an entry-level cycling computer packed with features, and the Edge 520 Plus offers advanced mapping and navigation capabilities. We also announced the Varia RTL510, the latest in our series of products that focus on cycling safety.

We hosted our second annual Connect IQ Developer Summit, bringing together application developers and business partners to participate in hands-on workshop with our product managers and our engineers. The momentum behind Connect IQ is accelerating, with more than 54 million Connect IQ downloads to more than 8 million compatible devices shipped since inception.

And finally, just yesterday, we announced the collaboration with the University of Kansas Medical Center on multiple research projects exploring the use of wearable technology for the early detection of underreported health conditions such as sleep apnea and atrial fibrillation.

Turning next to aviation. Revenue increased 19%, driven by broad-based strength across the market. Gross and operating margins remained strong at 75% and 33%, respectively, resulting in operating income growth of 25% over the prior year.

During the quarter, we started delivering our new TXi flight decks, including the version for the helicopter market. We also announced the first flight of the Citation XLS with the G5000 integrated avionics fleet. This represents a significant step forward on our path to certification.

Looking next at the marine segment. Revenue increased 9%, driven by our recent acquisition of Navionics. Excluding Navionics, our revenue was essentially flat year-over-year due to unfavorable weather conditions that have delayed the start of the boating season and due to the challenging comparisons in the first quarter of 2017, when our marine segment grew 26%. Gross margin improved to 59%, while operating margin declined to 12%. During the quarter, we announced the GCV 20, an ultra-high definition sonar offering high-resolution imaging at greater depths.

Also, we were selected as the exclusive marine electronics supplier to the Independent Boat Builders cooperative known as IBBI. IBBI is the boating industry's largest purchasing cooperative and is comprised of a 19-member network of leading brands. Beginning in 2019, members of the IBBI will get direct access to our full line of marine electronics.

Looking finally at the auto segment. Revenues were down 12% for the quarter due to the ongoing decline of the PND market, partially offset by growth in niche product lines. Gross margin was 43%, while operating margin was 2%. During the quarter, we announced the next-generation dezl PND for trucks, which uses dash camera technology to provide enhanced driver alerts.

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

Douglas Gerard Boessen *Garmin Ltd. - CFO, Principal Accounting Officer & Treasurer*

Thanks, Cliff. Good morning, everyone. I'll 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 \$711 million for the first quarter, representing 11% increase year-over-year. Gross margin was 60%, 190 basis point increase from the prior year, driven by segment and product mix. Operating expense as a percentage of sales was 40%, consistent with the prior year. Operating income was \$142 million, a 22% increase year-over-year. Operating margin was 20%, a 180 basis point increase from the prior year. Our GAAP pro forma EPS was \$0.68.

Next, looking at our first quarter revenue by segment. In the first quarter, we achieved record first quarter revenue of \$711 million. Consolidated revenue grew 11%, led by double-digit growth in 3 of our 5 segments. Both the outdoor and fitness segment grew over 20% for the quarter. Combined basis, outdoor, fitness, aviation and marine were up 18% compared to prior year quarter.

Looking next, first quarter revenue and operating income charts. Collectively, the outdoor, fitness, aviation and marine segments contributed 80% of total revenue to first quarter 2018 compared to 75% in the prior year quarter. Fitness grew from 22% to 23%, and outdoor grew from 18% to 20%. You can see from the charts illustrated our profit mix by segment. Outdoor, fitness, aviation and marine segments collectively contributed 98% of operating income in the first quarter 2018 compared to 94% first quarter of 2017. Outdoor, fitness and aviation segments each had year-over-year increase in both operating income dollars and operating margin.

Looking next at operating expenses. Our first quarter operating expenses increased by \$29 million, 11%. Research and development increased \$20 million year-over-year due to investments in engineering resources and recent acquisitions.

Advertising expense decreased \$7 million year-over-year, representing 3.5% of sales, 150 basis point decrease. The decrease was primarily due to lower media spend and lower coop expense.

SG&A was up \$15 million compared to prior year quarter, increased 60 basis points as a percent of sales to 16.5%. Increase was primarily due to personnel-related expenses and current costs associated with recent acquisitions, partially offset by lower litigation-related expenses.

Few highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with cash and marketable securities of approximately \$2.4 billion. Accounts receivable decreased sequentially to \$410 million following the seasonally strong fourth quarter. Our inventory balance increased on a sequential and year-over-year basis to prepare for the seasonally strong second quarter. In the first quarter 2018, we generated free cash flow of \$188 million, \$93 million increase from the prior quarter and benefited from working capital improvements.

Also in the quarter, we paid dividends of \$96 million. In the first quarter 2018, we reported an effective tax rate of 16% compared to a pro forma effective tax rate of 21.2% in the prior year quarter. The decrease in effective tax rate is primarily due to benefits from the U.S. tax reform and the impact of release of reserves.

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

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Operator

Thank you, ladies and gentlemen. That does conclude today's call. Thank you very much for your participation. You may all disconnect. Have a wonderful day.

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