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Q4 2018 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Garmin Ltd. Fourth Quarter 2018 Earnings Conference Call. (Operator Instructions)

I would now like to introduce your host for today's conference, Ms. Teri Seck, Manager of Investor Relations. Ma'am, you may begin.

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

Good morning. We'd like to welcome you to Garmin Ltd.'s Fourth 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 standards in the first quarter of 2018. The prior periods presented here have been restated to reflect adoption of this 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 introduction, future demand for our product 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 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 & Director***
Thank you, Teri, and good morning, everyone.

As announced earlier today, we finished 2018 strong, with revenue for the quarter increasing 4% over the prior year to $932 million. Aviation, marine, outdoor and fitness collectively increased 13% over the prior year. Gross margin improved to 58.9%, driven by both product and segment mix. Operating margin improved to 23.9%, and operating income increased 21% over the prior year. These results generated GAAP EPS of $1; and pro forma EPS of $1.02 in the quarter, an increase of 26%.

Looking briefly at full year performance. 2018 was our third consecutive year of revenue and operating income growth. We launched many innovative products, some of which have become halo products in their respective markets. I will highlight accomplishments in each of our business segment in a moment. But looking back at 2018, I'm very pleased with everything we accomplished. For the year, revenue increased 7% to over $3.3 billion. Combined revenue from aviation, marine, outdoor and fitness increased 16%. Gross margin improved to 59.1%. Operating margin improved to 23.3%, and operating income increased 14%. This resulted in GAAP EPS of $3.66; and pro forma EPS of $3.69, an increase of 22% over the prior year. The growth in EPS and cash generation gives us confidence in proposing an 8% increase in the quarterly dividend.

We shipped nearly 15 million units during the year, bringing our total to over 205 million since inception, which includes over 1 million certified aviation products. Doug will discuss our financial results in greater detail in a few minutes, but first, I would like to highlight some achievements from the past year and outlook in each of our 5 business segments.

Starting with aviation. Revenue increased 20%, driven by growth in both aftermarket and OEM product categories. ADS-B continues to be a driver of solid performance in the aftermarket, while new platforms and favorable market conditions led the growth in the OEM category. Gross and operating margins were 75% and 34%, respectively, and operating income increased 33% over the prior year. During the year, Tactical Air selected us to equip their fleet of F5 fighter aircraft, which is the second program win for our tandem-integrated flight deck. Also, during the year, we were recognized by Airbus helicopters and Embraer as outstanding Supplier of the Year. And most recently, Garmin was ranked #1 in avionics product support by Professional Pilot magazine and by Aviation International News for the 15th consecutive year. The recognition we are receiving is significant because the aviation industry demands strong performance from those that participate in the market. I congratulate our team on earning these awards, which is a testament to the quality of Garmin equipment and the amazing way our associates care for our customers. Looking ahead, positive market conditions, contributions from new products and platforms and ADS-B provide growth opportunities in both OEM and aftermarket product categories. With these things in mind, we anticipate revenue in the aviation segment will increase approximately 10% in 2019.

Looking next at marine. Revenue increased 18%, driven by strength in a broad range of product lines. During the year, we launched Panoptix LiveScope, a sonar system that generates realtime video-like images underwater. LiveScope was quickly recognized by the marine industry as disruptive new technology and has become a halo product in our marine portfolio. Gross and operating margins improved to 59% and 14%, respectively, and operating income increased 26%. We recently introduced new versions of our flagship GPSMAP and echoMAP chartplotters, which included a new map, combining the best of Garmin and Navionics content. This marks the achievement of a major objective we established for the Navionics acquisition. We continue to gain market share in the OEM category. During the year, we were named as an exclusive supplier to several boat manufacturers. We enter 2019 confident in our portfolio of strong product such as Panoptix LiveScope and our flagship GPSMAP and echoMAP series. We anticipate revenue in the marine segment will increase approximately 10% for the year.

Turning next to outdoor. Revenue increased 16% on strong demand for outdoor adventure watches, golf products and inReach subscription services. Gross and operating margins were 65% and 36%, respectively, and operating income increased 16% over the prior year. During the year, we built on the momentum in the adventure watch category with the introduction of the fenix 5 Plus series with streaming music, built-in maps and mobile payments. We also extended the category with the introduction of Instinct and Descent. Looking ahead, we anticipate revenue in the outdoor segment will increase approximately 10% in 2019, driven primarily by growth in watches and inReach subscriptions.

Looking next to fitness. Revenue increased 13%, driven by growth in all product categories. Gross and operating margins were 55% and 21%, respectively, and operating income increased 24% over the prior year. In 2018, we launched new music-enabled wearables and added 7 music providers into our Connect IQ app store, including Spotify, Deezer and KKBOX. Lastly, we signed an agreement to purchase Tacx, a leading provider of indoor bike trainers, and we expect this acquisition to be completed sometime in the second quarter. In 2019, we anticipate revenue growth of approximately 13%, which includes the acquisition of Tacx as well as organic growth within the segment.

Looking finally at the auto segment. Revenue decreased 19% for the full year due to the ongoing decline of the PND market and lower auto OEM sales, driven by program timing. Gross and operating margins were 43% and 6%, respectively. Our global PND market share remains very strong. And at the recent Consumer Electronics Show, we announced our new Drive PNDs with simplified road trip-ready features. In the OEM category, we were awarded new business that will contribute starting in 2020. Looking at

2019, we anticipate revenue will decrease approximately 18%, driven by the ongoing decline of the PND market as well softness in OEM due to program timing mentioned earlier.

In summary, we began our 30th year of operations with opportunities in all segments. We anticipate revenue of approximately $3.5 billion, up 5% year-over-year. Our plan calls for stronger growth in the second half of the year due to the timing of product launches. We anticipate gross margin of approximately 59.5% and operating margin of approximately 22.7%. We anticipate a full year pro forma effective tax rate of approximately 16.5%, resulting in pro forma earnings per share of approximately $3.70.

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

Douglas Gerard Boessen ***Garmin Ltd. - CFO, Principal Accounting Officer & Treasurer***
Thanks, Cliff. Good morning, everyone. I'll begin my review in our fourth quarter and full year financial results with comments on the balance sheet, cash flow statement and taxes.

We posted revenue of $932 million for the fourth quarter, representing 4% increase year-over-year. Gross margin was 58.9%, a 280 basis point increase from the prior year. Operating expense as a percentage of sales was 35%, a 70 basis point decrease from the prior year. Operating income was $223 million, a 21% increase with the prior year. Operating margin was 23.9%, a 350 basis point increase from the prior year. Our GAAP EPS was $1. Pro forma EPS was $1.02, a 26% increase from the prior year.

Looking at full year results. We posted revenue over $3.3 billion for the year, representing a 7% increase year-over-year. Gross margin was 59.1%, 150 basis point increase from the prior year. Operating expense as a percentage of sales was 35.9%, a 20 basis point increase from the prior year. Operating income was $778 million, a 14% increase over the prior year. Operating margin was 23.3%, an increase of 140 basis points from the prior year, driven by the increase in gross margin. Our GAAP EPS was $3.66. Pro forma EPS was $3.69, a 22% increase from the prior year.

Next, look at fourth quarter and full year revenue by segment. During the fourth quarter, we achieved double-digit growth in 3 of our 5 segments led by the outdoor segment with 25% growth, followed closely by the aviation segment with growth of 22%. For the full year 2018, we achieved 7% consolidated growth with double-digit growth in 4 of our 5 segments.

Looking next to fourth quarter revenue and operating income. Collectively, the aviation, marine, outdoor, fitness segments contributed 84% total revenue in the fourth quarter 2018 compared to 77% in the prior year quarter. Outdoor grew from 23% to 27%. Aviation grew from 14% to 17%. You can see from the charts, it illustrate our profit mix by segment. The aviation, marine, outdoor and fitness segments collectively delivered 97% operating income in the fourth quarter 2018 compared to 88% in the fourth quarter of 2017. Outdoor operating income as a percentage of total operating income increased from 40% to 43%.

Looking next at full year charts. For the full year, the aviation, marine, outdoor, fitness segments made up 81% of total revenue compared to 75% in 2017. A similar shift occurred in operating income with 95% in 2018 operating income collectively coming from the aviation, marine, outdoor and fitness segments compared to 88% in 2017. All segments besides auto had a year-over-year increase in both operating income dollars and operating margin.

Looking next at operating expenses. Fourth quarter operating expenses increased by $6 million or 2%. Research and development increased $12 million year-over-year due to investments in engineering resources. Our advertising expense decreased $4 million in the prior year quarter, representing 5.9% of sales, 60 basis point decrease. Decrease was primarily due to lower media spend in the fitness segment. SG&A decreased $3 million compared to prior quarter, with 13.5% of sales, 90 basis point decrease compared to prior year. Decrease was due to prior year litigation-related costs, partially offset by increased personnel-related expenses.

A few highlights on the balance sheet, cash flow statement and dividend payments. We ended the quarter with cash and marketable securities of approximately $2.7 billion. Accounts receivable increased sequentially to $570 million due to holiday quarter and decreased year-over-year due to timing of cash receipts. Inventory balance increased both sequentially and year-over-year to $562 million. During the fourth quarter 2018, we generated free cash flow of approximately $185 million. For the full year 2018, we generated free cash flow of approximately $764 million, a $243 million increase to the prior year. We announced that we plan to seek shareholder approval for our increased dividend beginning for the June 2019 payment. Proposal is a cash dividend of $2.28 per share, $0.57 per share per quarter, 8% increase from our current quarterly dividend of $0.53 per share.

For the full year 2018, we recorded an effective tax rate of 15.7%, 520 basis point decrease from the prior year, primarily due to benefits from U.S. tax reform. We expect our full year 2019 pro forma effective tax rate to be approximately 16.5%. The year-over-year increase in 2019 pro forma effective tax rate is primarily due to lower expected reserve releases compared to 2018.

This concludes our formal remarks. Chanel, please open the line for Q&A.

Teri Seck ***Garmin Ltd. - Manager of IR***
Thanks, everyone. Doug and I are available for callbacks throughout the day. Have a good one. Bye.

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