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Q1 2019 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Garmin Limited's First Quarter 2019 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to turn the conference over to Teri Seck, Manager of Investor Relations. Ma'am, you may begin.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning. We would like to welcome you to Garmin Limited's First Quarter 2019 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.

In the first quarter of fiscal 2019, we refined the methodology used to allocate certain selling, general and administrative expenses to the segments. The composition of segments did not change. Prior year amounts are presented as they were originally reported as it is not practical to accurately restate prior period activity in accordance with the refined allocation methodology.

For comparative purposes, we had included in the appendix of this webcast an estimate of the segment operating income impact if the refined allocation methodology would have been used in 2018 for both the 13 weeks ended March 31, 2018, and the 52 weeks ended December 29, 2018. There was no change to either the consolidated SG&A expenses nor the consolidated operating income.

This earnings call includes projections and other forward-looking statements regarding Garmin Limited and its business. In these statements regarding our future financial position, revenues, earnings, gross and operating margins and future dividends, market shares, product introduction, 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 Limited 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, Garmin reported record revenue for the first quarter of 2019 with growth in operating income and EPS.

Consolidated revenue came in at \$766 million, up 8% over the prior year. Revenue for marine, aviation, fitness and outdoor collectively increased 12% year-over-year.

Gross margin was 59% compared to 60% in the prior year. Operating margin was 19.8% and operating income grew 6% over the prior year. This resulted in GAAP EPS of \$0.74. Pro forma EPS was \$0.73, up 7% over the prior year.

We are encouraged by our first quarter results. 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.

Before moving onto segment highlights, I want to mention the recognition we received recently from Forbes, who ranked Garmin as one of the top 5 best employers in America. Speaking on behalf of all Garmin employees, we are truly honored to receive this recognition. Garmin employees are passionate about what we do and we share a deep commitment to serving our customers and each other. Of the many qualities that make Garmin a great place to work, it's the commitment of our employees that sets us apart.

Moving next to our segment highlights. Revenue in the marine segment increased 18% on strong demand for chartplotters and Panoptix LiveScope sonars. Gross margin was 58% and operating margin improved to 19%. During the quarter, we announced the ECHOMAP ultra series, combining built-in Panoptix LiveScope compatibility with new mapping content. Also in our first year as their exclusive

electronic supplier, we were named the 2018 supplier of the year by Independent Boat Builders Incorporated, the boating industry's largest purchasing cooperative. It's an honor to be recognized by the IBBI. And I want to thank our marine team for delivering superior products, service and support to our customers.

Looking next at aviation. Revenue increased 17%, driven by growth in both aftermarket and OEM product categories. Gross and operating margin remained strong at 75% and 34%, respectively. During the quarter, we delivered the new G1000 NXi upgrade for the Citation Mustang, which is the first business jet to adopt our G1000 system.

We announced compelling new products such as the GPS 175, GNX 375 and the G3X Touch, which expand the addressable market for our retrofit systems.

Our aviation team was also recognized as an outstanding supplier to the industry. At the recent Embraer Suppliers Conference, we were named Supplier of the Year for electrical systems. This is the 10th supplier award we received from Embraer, and again, reflects the strength of our products, service and support. I want to thank our aviation team for their deep commitment to being the very best.

Looking next at fitness. Revenue increased 9%, driven primarily by strong growth in our wearable categories. Gross margin was 50% and operating margin was 10% in the quarter. Margins decreased due to a combination of factors, including lower selling prices and a shift in mix as certain products in our consumer wellness categories experienced significant year-over-year growth.

In early April, we completed the acquisition of Tacx, expanding our reach into the indoor cycling and training market. Yesterday, we announced the fully refreshed line of running watches with the Forerunner 45 in 2 sizes, the Forerunner 245 with optional music storage and the Forerunner 945, which has it all. These new smart watches offer features that will appeal to a broad range of running enthusiasts.

Also, we announced the availability of our menstrual cycle tracking feature. This new feature was developed by Garmin women focusing on the special needs of those who are highly active. This feature will help women make connection between their current cycle phase, physical and emotional symptoms and their overall well-being. We also announced that we are cooperating with the University of Kansas on research to better understand how wearables and the biometric data they produce can help women manage and improve their health.

Moving to outdoor. Revenue increased 7% on strength across multiple product categories. The outdoor segment generated strong gross and operating margins of 63% and 27%, respectively. During the quarter, we introduced MARQ, a collection of 5 premium smart tool watches. These watches were created from our active lifestyle DNA to inspire adventurers in flying, racing, sailing, exploring and sports performance.

Also, we recently announced the Approach S40, a stylish golf watch, featuring a color touchscreen display and smart watch capabilities.

Looking finally at the auto segment. Revenue decreased 10% for the quarter due to the ongoing decline of the PND market, partially offset by growth in certain specialty product lines. Our global PND market share remains very strong. Gross margin was 45% and operating margin improved to 6%.

During the quarter, we launched the BC 40, a new wireless backup camera that's easy to install and provides drivers with a wide clear view behind their vehicle.

Also during the quarter, we announced that BMW selected us as their lead design and production partner of entertainment modules for the BMW group, validating us as a Tier 1 supplier to the world's most respected brands. I congratulate our automotive team and thank them for their hard work and dedication in securing this win.

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 with comments on the balance sheet, cash flow statement and taxes.

We posted revenue of \$766 million in the first quarter, representing 8% increase year-over-year. Gross margin was 59%, 100 basis point decrease from the prior year. Operating expense as a percentage of sales was 39.2%, 80 basis point decrease from the prior year. Operating income was \$151 million, a 6% increase year-over-year.

Operating margin was 19.8%, relatively consistent to the prior year. Our GAAP EPS was \$0.74 and pro forma EPS was \$0.73.

Next, we'll look at the first quarter revenue by segment. We achieved record first quarter revenue of \$766 million. Consolidated revenue grew 8%, led by double-digit growth in both marine and aviation. Also, both the fitness and outdoor segments achieved solid growth during the quarter. On a combined basis, marine, aviation, fitness and outdoor were up 12% compared to the prior year quarter.

Looking next, the first quarter revenue and operating income charts. Collectively, marine, aviation, fitness and outdoor segments contributed 83% of total revenue in the first quarter of 2019 compared to 80% in the prior year quarter. Marine grew from 16% to 17%, aviation grew from 21% to 22% and fitness grew from 23% to 24%.

You can see from the charts, it illustrates our profit mix by segment. Marine, aviation, fitness and

outdoor segments collectively delivered 95% of operating income in the first quarter of 2019 compared to 98% in the first quarter of 2018.

Looking next at operating expenses. Our first quarter operating expense increased by \$16 million or 6%. Research and development increased \$4 million year-over-year due to investments in engineering resources. Our advertising expense increased approximately \$3 million year-over-year, representing 3.6% of sales, consistent with the prior year quarter.

SG&A was up \$10 million or 16.5% of sales, consistent with the prior quarter. The increase was primarily due to legal-related costs and personnel-related expenses.

A few highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with cash and marketable securities of approximately \$2.7 billion. Accounts receivable decreased sequentially to \$453 million following a seasonally strong fourth quarter. Inventory balance increased on a sequential and year-over-year basis as we prepare for the seasonally strong second quarter upcoming product launches.

During the first quarter of 2019, we generated free cash flow of \$134 million, \$53 million decrease from the prior year quarter. Also during the quarter, we paid dividends of \$201 million, which includes both the December 2018 and March 2019 payments.

During the first quarter of 2019, we reported an effective tax rate of 15.7% compared to 16% in the prior year quarter.

This concludes our formal remarks. Shannon, can you 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, this concludes today's conference. Thanks for your participation, and have a wonderful day.

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