THOMSON REUTERS

FINAL TRANSCRIPT

Q2 2019 Garmin Ltd Earnings Call

EVENT DATE/TIME: JULY 31, 2019 / 2:30PM GMT

CORPORATE PARTICIPANTS

Clifton Albert Pemble *Garmin Ltd. - President, CEO & Director*

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

Teri Seck *Garmin Ltd. - Manager of IR*

CONFERENCE CALL PARTICIPANTS

Benjamin James Bollin *Cleveland Research Company - Senior Research Analyst*

Charles Lowell Anderson *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst*

Erik William Richard Woodring *Morgan Stanley, Research Division - Research Associate*

Ivan Philip Feinseth *Tigress Financial Partners LLC, Research Division - Director of Research*

Jeangul Chung *JP Morgan Chase & Co, Research Division - Analyst*

Nikolay Todorov *Longbow Research LLC - Analyst*

Richard Frank Valera *Needham & Company, LLC, Research Division - Senior Analyst*

William Verity Power *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

PRESENTATION

Operator

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

I would now like to introduce your host for today's conference, Teri Seck, Investor Relations Manager. You may begin.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning. We would like to welcome you to Garmin Ltd.'s Second 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.

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 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 & Director***

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin reported strong results including record revenue and operating income for the second quarter.

Consolidated revenue for the quarter came in at $955 million, up 7% over the prior year. Aviation, marine, fitness and outdoor collectively increased 12% year-over-year.

Gross margin improved to 60.3%. Operating margin expanded to 26.8%. Operating income increased 18% to $256 million. This resulted in GAAP EPS of $1.17 and pro forma EPS of $1.16 in the quarter, up 17% over the prior year.

We are pleased with our performance for the first half of 2019, and these strong results give us confidence to raise our full year guidance. 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 our business segments.

Starting with the aviation segment. Revenue increased 20% driven by growth in both aftermarket and OEM product categories. We experienced strong growth in our ADS-B product offerings. Gross and operating margins remained strong at 75% and 36%, respectively, resulting in operating income growth of 27% over the prior year.

During the quarter, we achieved certification of the G5000 integrated flight deck for the Citation Excel and XLS, bringing a state-of-the-art cockpit system to this popular family of aircraft. We also announced the availability of the NXi upgrade for Cessna and Beechcraft models equipped with the original G1000 system. We continue to see strong customer demand and appreciation for this upgrade program.

As I mentioned earlier, ADS-B has been a significant driver of growth in our aviation business. According to the FAA, as of July 1, 2019, approximately 91,000 total aircraft have been equipped, of which approximately 7,000 are commercial aircraft. Of the remaining 84,000, Garmin has captured roughly 80% market share. Based on everything we see, it is likely that the ADS-B opportunities will continue into 2020.

While ADS-B has been a significant opportunity, it's not the only opportunity for the aviation segment. New OEM platforms, retrofit cockpit systems, NXi upgrades and the growing demand for trainer aircraft represent opportunities for growth beyond the ADS-B cycle. We are optimistic about the future of our aviation business.

Looking next at marine. Revenue increased 13% as we experienced strong demand for our chartplotters and Panoptix LiveScope sonars. Gross and operating margins were 61% and 28%, respectively, resulting in strong operating income growth.

Last quarter, we mentioned that the Independent Boat Builders, Inc. named Garmin its supplier of the year. I'm pleased to report that our relationship with IBBI has expanded and now includes audio equipment. Our Fusion brand of marine electronic systems was selected by IBBI as the preferred choice for its members.

New markets and new product category is an area of strategic growth because they represent significant growth opportunities. In keeping with this strategy, at the recent ICAST fishing show, we introduced Force, our first entry into the freshwater trolling motor market. Force was named best new boating accessory and won the coveted Best of Show award for 2019, making Garmin a back-to-back Best of Show winner at ICAST. We are very proud of the accomplishments of our marine team, and we're excited about the new opportunity that Force represents in this segment.

Looking next at the fitness segment. Revenue increased 12% driven by growth in running products as well as contributions from our recent acquisition of Tacx. Gross and operating margins were 54% and 20%, respectively. During the quarter, we began shipping our refreshed line of Forerunners, providing both smart watch features and enhanced running dynamics for all capabilities of runners. We also completed the acquisition of Tacx and are now in the process of expanding the distribution of Tacx products through Garmin retailers.

Turning next to the outdoor segment. Revenue increased 4% on a year-over-year basis driven by growth in our golf and inReach products. We believe this is a remarkable accomplishment considering the significant impact of the fenix 5 Plus launch during the first half of 2018. Gross and operating margins were 64% and 34%, respectively.

During the quarter, we began shipping the MARQ luxury watch. In addition, we experienced strong demand for golf wearables and the Instinct adventure watch. We also introduced a refreshed line of handheld navigators adding inReach satellite communication technology to our flagship handheld devices.

Looking finally at the auto segment. Revenue decreased 13% due to the ongoing decline of the PND market. Gross and operating margins improved year-over-year to 48% and 16%, respectively. Our global market share position in the PND category remains very strong. We launched the DriveSmart 65 with integrated Alexa personal assistant, bringing enhanced voice-controlled functionality to drivers. We also announced the Garmin Overlander, an all-terrain GPS navigator specifically designed to fit the needs of the growing over lending community. This is a unique product offering for those looking to explore off the grid.

In summary, we are very pleased with our results in the first half of 2019. Given this strong performance, we are raising our projected revenue to approximately $3.6 billion for the year, representing an 8% increase over the prior year. Gross margin is projected to be 59.5% for the year. Operating margin is projected to be 23.2%. Assuming a pro forma effective tax rate of 16.5%, pro forma earnings per share is expected to be approximately $3.90.

Looking at our annual revenue outlook by segment, we have increased our growth expectations for the aviation segment to 17%, the marine segment to 12% and the auto segment to down 15%. Fitness and outdoor are unchanged.

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 begin by reviewing our second quarter financial results with comments on the balance sheet, cash flow statement and taxes.

We posted revenue of $955 million for the second quarter representing 7% increase year-over-year. Gross margin was 60.3%, 180 basis point increase from the prior year.

Operating expense as a percentage of sales was 33.4%, 80 basis point decrease from the prior year. Operating income was $256 million, 18% increase year-over-year. Operating margin was 26.8%, 250 basis point increase from the prior year. Our GAAP EPS was $1.17. Our pro forma EPS was $1.16, a 17% increase from the prior year.

Next, we'll look at our second quarter revenue by segment. We achieved record second quarter revenue of $955 million. Consolidated revenue grew 7% led by double-digit growth in our aviation, marine and fitness segments. Also the outdoor segment had solid growth during the quarter. Combined basis, aviation, marine, fitness and outdoor were up 12% compared in the prior year quarter.

Looking next at second quarter revenue and operating income. On a combined basis, aviation, marine, fitness and outdoor segments contributed 83% of total revenue in the second quarter of 2019 compared to 80% in the prior year quarter. Aviation grew from 17% to 19%. Marine grew from 15% to 16%. And fitness grew from 25% to 26%. You can see it on the charts, it illustrate our profit mix by segment. On a combined basis, aviation, marine, fitness and outdoor segments delivered 90% of operating income in the second quarter 2019 compared to 94% in the second quarter of 2018. The aviation, marine and auto segments had strong year-over-year increases and operating income dollars improved operating margins.

Looking next at operating expenses. Second quarter operating expenses increased by $13 million or 4%. As a percentage of sales, operating expenses were 33.4% in the second quarter 2019, 80 basis point decrease from the comparable quarter last year.

Research and development increased $7 million year-over-year in investments entering resources. Advertising expense was down $2 million from the prior year due to lower expenses in our auto segment.

SG&A was up $8 million compared to prior year quarter, relatively flat as a percentage of sales. The increase was primarily due to personnel-related expenses, incremental costs associated with recent acquisitions.

A 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 increased sequentially and year-over-year to $584 million due to strong quarter -- second quarter sales. The inventory balance increased sequentially year-over-year to $648 million due to timing of new products, raw material requirements, acquisition of Tacx.

For the second quarter of 2019, we generated free cash flow of $80 million, a $77 million decrease from the prior year quarter. Also during the quarter, we paid dividends of $108 million.

In the second quarter 2019, reported effective tax rate of 18.9% compared to effective tax rate of 19.4% in the prior year quarter. We continue to expect our full year 2019 pro forma effective tax rate to be approximately 16.5%.

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

Teri Seck ***Garmin Ltd. - Manager of IR***
Great. Thank you, everyone, for calling in. Doug and I are available for callbacks throughout the day. Have a wonderful one.

Operator
Ladies and gentlemen, thank you for your participation in today's conference. This concludes the program. You may now disconnect.
