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Q3 2019 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Garmin Ltd. Third Quarter 2019 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Teri Seck, Head of Investor Relations. Please go ahead.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning. We would like to welcome you to Garmin Ltd.'s Third 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 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 & Director*

Thanks, Teri, and good morning, everyone. Earlier today, Garmin reported another strong quarter of revenue growth, up 15% to \$934 million. Aviation, fitness, outdoor and marine collectively increased 24% and contributed 85% of total revenues.

Gross margin improved to 60.7%. Revenue growth and expanding margins resulted in significant operating leverage in the business. Operating income increased 33% year-over-year to \$261 million and operating margin expanded to 28%. This resulted in GAAP EPS of \$1.19 and pro forma EPS of \$1.27 in the quarter.

We are pleased with our performance in the first 3 quarters of 2019, and these strong results give us confidence to raise our full year guidance, which I'll explain in a moment.

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 28%, driven by growth in both OEM and aftermarket systems. Gross and operating margins remained strong at 74% and 35%, respectively, resulting in operating income growth of 30% over the prior year.

Growth in OEM systems was driven primarily by the recent certification of a Citation Longitude, featuring our G5000 integrated flight deck. However, the strength was broad-based as other aircraft platforms also contributed to the growth. Growth in aftermarket systems was driven by strong ADS-B sales and the recently certified G5000 integrated flight deck with the Citation XL and XLS.

During the quarter, the G1000H NXI was certified in the Bell 407GX helicopter, representing the first IFR certification for this advanced helicopter flight deck.

I'd like to highlight this morning's Autoland announcement. This new safety technology is designed to return an aircraft and its passengers safely to the ground in the event a pilot is unable to do so. We believe Autoland is a disruptive new technology that will change the way people think about safety in general aviation aircraft. Autoland will soon be available as part of the G3000 integrated flight deck on the Cirrus Vision Jet and the Piper M600 pending final FAA certification.

Turning next to the fitness segment. Revenue increased 28%, primarily driven by growth in wearables and contributions from Tacx. Gross and operating margins were 52% and 20%, respectively, resulting in operating income growth of 33% over the prior year.

At (inaudible), which is Europe's leading consumer electronics trade show, we now a sweeping update to our line of consumer wearable products including new versions of the vívoactive series in 2 sizes, the vívomove 3 hybrid smartwatch series and the all-new Venu smartwatch featuring a brilliant AMOLED

color touchscreen display, comprehensive health and fitness features and long battery life.

We also announced the Tacx NEO 2T smart trainer featuring enhanced drive design and performance analytics to simulate an outdoor ride as realistically and quietly as possible.

Turning next to the outdoor segment. Revenue increased 23% on a year-over-year basis with growth in multiple product categories led by adventure smartwatches. Gross and operating margins improved year-over-year to 66% and 41%, respectively, resulting in strong operating income growth for the segment.

At the recent UTMB trail running event, we launched the fenix 6 adventure smartwatch series with larger displays and innovative performance features. We also introduced the fenix 6X Pro Solar, the first of its kind with our exclusive solar harvesting technology.

We have often mentioned that inReach technology has been a growth driver for the outdoor segment and that was definitely the case in this most recent quarter. I'm pleased to report that inReach recently passed a significant milestone facilitating over 4,000 SOS incidents since its launch in 2011, demonstrating the crucial importance of satellite-based 2-way messaging wherever our customers need assistance. We believe inReach has room to grow in the future as more people recognize its potential to change outcomes and save lives.

Turning next to the marine segment. Revenue increased 9% as we saw solid sales across multiple product categories led by chartplotters. Gross and operating margins improved year-over-year to 60% and 19%, respectively, resulting in strong operating income growth for the segment.

During the quarter, we were named Manufacturer of the Year by the National Marine Electronics Association for the fifth consecutive year, reflecting the strength of our innovative products and our leading market position.

We were also named the exclusive marine electronics provider by both Regulator Marine and Sea Hunt, solidifying our leadership in the premier center console boat market.

Looking finally at the auto segment, revenue decreased 17%, primarily driven by declines in our OEM business and the ongoing PND market contraction. Our global market share position in the PND category remains very strong. Gross and operating margins improved year-over-year to 48% and 15%, respectively, resulting in operating income growth of 39%.

During the quarter, we began shipping the Overlander all-in-one navigation device, which is the new product category designed for the growing community of overland adventure enthusiasts.

So in summary, we're very pleased with the results in the first 3 quarters of 2019. Given this strong performance, we're raising our projected full year revenue to approximately \$3.65 billion.

We're maintaining our full year gross margin at approximately 59.5% and raising our full year operating margin to approximately 24.3%.

We're also updating our full year pro forma effective tax rate to approximately 16%, resulting in pro forma earnings per share of approximately \$4.15.

So looking quickly at guidance by segment, we've increased growth expectations for aviation to 20%, fitness to 16% and the outdoor segment to 11%. Guidance for the auto and the marine segments 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'll begin by reviewing our third quarter financial results, give some comments on the balance sheet, cash flow statement and taxes.

We posted third quarter revenue of \$934 million, representing 15% increase year-over-year. Gross margin was 60.7%, 130 basis point increase from the prior year. Operating expense as a percentage of sales was 32.7%, a 240 basis point decrease from the prior year.

Operating income was \$261 million, a 33% increase year-over-year. Operating margin was 28%, a 380 basis point increase from the prior year. Our GAAP EPS was \$1.19 and our pro forma EPS was \$1.27, a 27% increase from the prior year.

Next, we'll look at third quarter revenue by segment. We achieved record third quarter revenue of \$934 million. Consolidated revenue grew 15%, led by solid double-digit growth in our aviation, fitness and outdoor segments. Also, marine segment had solid growth of 9% during the quarter.

On a combined basis, aviation, fitness, outdoor and marine were up 24% compared to the prior year quarter.

Looking next at third quarter revenue and operating income. On a combined basis, aviation, fitness, outdoor and marine segments contributed 85% of total revenue in third quarter 2019 compared to 80% in the prior year quarter. Aviation grew from 18% to 20%, fitness grew from 24% to 26% and outdoor grew from 26% to 28%.

You can see from the chart to illustrate our profit mix by segment. Combined basis, the aviation, fitness, outdoor and marine segments delivered 92% operating income in the third quarter of 2019 and 2018. All 5 segments had strong year-over-year increases and operating income dollars improved operating margins.

Looking next at operating expenses. Our third quarter operating expenses increased by \$21 million or 7%. As a percentage of sales, operating expenses were 32.7% in the third quarter of 2019, 240 basis decrease in the comparable quarter last year.

Research and development increased \$10 million year-over-year due to investments and engineering resources. Our advertising expense was up \$2 million from the prior year quarter due to higher outdoor and fitness expenses, partially offset by lower expenses in the auto segment.

SG&A was up \$10 million from the prior year quarter, but decreased as a percentage of sales. 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 \$2.5 billion. Accounts receivable decreased sequentially due to seasonal trends and increased year-over-year to \$558 million due to strong third quarter sales.

Inventory balance increased sequentially to \$750 million prepared for the seasonally strong fourth quarter. The year-over-year increase is due to timing of new products, acquisition of tax and efforts increase date of supply to support our increasingly diversified product lines.

During the third quarter 2019, we generated free cash flow of \$158 million. During third quarter of 2019, we report an effective tax rate of 11.6% compared to effective tax rate of 8.5% in the prior year quarter. Increase in effective tax rate is primarily due to lower income tax reserve releases in the third quarter of 2019.

Also, we've updated our guidance for the full year pro forma effective tax rate to approximately 16%. This concludes our formal remarks.

Livia, can you please open the line for Q&A?

Teri Seck *Garmin Ltd. - Manager of IR*

Thank you, everyone. As usual, Doug and I will be available for callbacks throughout the day. Have a good one. Bye.

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