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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Garmin Ltd. Fourth Quarter 2019 Earnings Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to your host, Teri Seck, Manager of Investor Relations.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning, everyone. We would like to welcome you to Garmin Ltd. Fourth Quarter of 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 transcripts 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, growth 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 the 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, we finished 2019 strong, with revenue for the quarter increasing 18% over the prior year to $1.1 billion. Fitness, aviation, marine and outdoor collectively increased 24% over the prior year.

Gross margin was 58% compared to 58.9% during the prior year. Operating margin improved to 25.1%, and operating income increased 24% over the prior year. These results generated GAAP EPS of $1.89 and pro forma EPS of $1.29 in the quarter, an increase of 26%.

Looking briefly at our full year performance. 2019 was a remarkable year of accomplishments. Revenue increased 12% to over $3.7 billion, representing a new record for Garmin. Combined revenue from fitness, aviation, marine and outdoor increased 18%. Gross margin improved to 59.5%. Operating margin improved to 25.2%, and operating income increased 21% to $946 million, another record achievement. This resulted in GAAP EPS of $4.99 and pro forma EPS of $4.45, an increase of 21% over the prior year.

In light of these strong results, at our upcoming annual meeting, we'll be asking shareholders to approve an annual dividend of $2.44 a share, representing a 7% increase. Doug will discuss financial results in greater detail in a few minutes, but first, I'd like to highlight some achievements from the past year and our outlook in each of our 5 business segments.

2019 was an outstanding year for our fitness segment, with each product category performing well. During the year, we launched sweeping updates to our running, wellness and cycling product lines, and these products were strong contributors in the final quarter of the year. In addition, our recent acquisition of Tacx brought new revenue to the segment and expanded our ability to serve cycling customers indoors and outdoors all year long.

For the year, revenue from fitness increased 22%, exceeding the $1 billion threshold for the first time. Gross and operating margins were 51% and 18%, respectively, and operating income increased 6% over prior year.

In 2020, we plan to build on this momentum by launching new feature-rich products while also expanding the distribution of Tacx products. As a result, we anticipate revenue from the fitness segment will increase approximately 10% for the year.

2019 was an extraordinary year for our aviation segment. ADS-B was a significant contributor to growth, but on a combined basis, other categories contributed even more. We experienced growth in aftermarket systems as customers recognize the strong value proposition of modern cockpit electronics. We also experienced growth in OEM systems driven by popular new aircraft and from increasing demand for trainer aircraft.

For the year, revenue from aviation increased 22%. Gross and operating margins were 74% and 34%, respectively, and operating income increased 24% over the prior year. For 2020, we anticipate that revenue for aviation will be comparable to that of 2019 as growth in aftermarket systems is offset by declining ADS-B revenues.

Trends in the broader OEM market should be in line with those of 2019. We anticipate that the early part of the year will be the strongest driven by residual ADS-B demand, followed by a weaker back half as we move past the inevitable peak of the ADS-B cycle. We are focused on opportunities that lie ahead, and we are confident in the long-term growth prospects for our aviation business.

Our marine segment delivered another year of impressive results, and market growth and market share gains boosted our performance. From time to time, we've highlighted our HALO products and technologies, achievements that speak for themselves and cast a positive glow across the entire Garmin brand. Our Panoptix LiveScope sonar system is one example that is generating excitement and strong sales across a broad range of products. We also introduced our first electric trolling motor, which is a new product category for us and bring game-changing new features to the market.

For the year, revenue from marine increased 15%, exceeding the $500 million threshold for the first time. Gross and operating margins improved to 60% and 22%, respectively, and operating income increased 73%.

Looking forward, interest in our products remained very strong, entering the 2020 boating season. In addition, our market share in the OEM category will grow as some of the most respected boat brands adopt our products as standard equipment on their 2020 models. With this in mind, we anticipate revenue from the marine segment will increase approximately 10% for the year.

Outdoor delivered another strong year of product achievements and revenue growth. During the year, we launched the MARQ luxury watch series, and we completely refreshed the fenix adventure watch series. We also introduced versions of the fenix with passive solar recharging technology, which has resonated positively with the market.

For the year, revenue from outdoor increased 13%. Gross and operating margins were 65% and 36%, respectively, and operating income increased 15% over the prior year. Looking ahead, we believe that the adventure watch category will continue to grow driven by further innovation in new utility. We also believe that inReach will continue to grow as more people appreciate the convenience and life-saving potential of 2-way remote communication. With these things in mind, we anticipate revenue from the outdoor segment will increase approximately 10% for the year.

Our auto segment also delivered many strong achievements in 2019. We integrated the Alexa digital assistant into our PND product line, and we entered a new product category with the launch of the Overlander navigation device.

At the recent Consumer Electronics Show, we announced the new Dash Cam Tandem that captures quality video both inside and outside the vehicle, regardless of lighting conditions. During the year, we also secured a significant backlog of new business as a Tier 1 supplier to the world's most respected automakers.

For the year, revenue from auto decreased 14%. Gross and operating margins improved to 47% and 10%, respectively, and operating income increased 50% over the prior year. Looking ahead, we believe that the negative trends in auto will moderate as contributions from specialty categories increase and as previously announced OEM programs contribute in the back half of the year.

2020 will also be a year of accelerated investment to support recently awarded programs. We are equipping our manufacturing facility in Olathe for auto OEM production. We are opening a new manufacturing facility in Europe that will be dedicated to auto OEM production. We also plan to hire additional resources in engineering and operations to support these complex, intensive development programs. With these things in mind, we anticipate that revenue from the auto segment will decrease 5% for the year.

In summary, we are excited about the opportunities we see in every business segment. For 2020, we anticipate consolidated revenue will reach approximately $4 billion, up 6% year-over-year as growth in fitness, outdoor and marine more than offset a slight decline in the auto segment. We anticipate that revenue in aviation will be comparable to that of 2019.

We anticipate gross margin of approximately 59.2% and operating margin of approximately 23.5%, reflecting our plans for an increased level of investment to support long-term growth initiatives. We anticipate a full year pro forma effective tax rate of approximately 10%, resulting in a pro forma earnings per share of approximately $4.60.

Our estimated tax rate will be favorably impacted by an intercompany transaction to migrate the ownership of a consumer intellectual property from Switzerland to the United States over the next several years. Doug will be providing more details on this in a few moments.

So that concludes my remarks. Next, Doug will walk you through additional details on our financial results and outlook. Doug?

Douglas Gerard Boessen ***Garmin Ltd. - CFO, Principal Accounting Officer & Treasurer***
Thanks, Cliff. Good morning, everyone. Let's begin by reviewing our fourth quarter and full year financial results and give comments on the balance sheet, cash flow statement and taxes.

We posted revenue over $1.1 billion for the fourth quarter, representing 18% increase year-over-year. Gross margin was 58%, a 90 basis point decrease from the prior year. Operating expense as a percentage of sales was 32.9%, 210 basis point decrease from the prior year. Operating income was $277 million, a 24% increase from the prior year. Operating margin was 25.1%, 120 basis point increase from the prior year. Our GAAP EPS was $1.89, and pro forma EPS was $1.29, a 26% increase from the prior year.

Looking at the full year results, we posted revenue of over $3.7 billion, representing a 12% increase year-over-year. Gross margin was 59.5%, 40 basis point increase from the prior year. Operating expense as a percentage of sales was 34.3%, 160 basis point decrease from the prior year. Operating income was $946 million, a 21% increase over the prior year. Operating margin was 25.2%, increase of 190 basis points from the prior year. Our GAAP EPS was $4.99. Pro forma EPS was $4.45, a 21% increase from prior year.

Next, look at fourth quarter and full year revenue by segment. During the fourth quarter, we achieved strong double-digit growth in 4 of our 5 segments led by fitness segment at 34% growth, followed by the aviation and marine segments with growth of 22% and outdoor with growth of 16%. For the full year 2019, we achieved 12% consolidated growth, double-digit growth in 4 of our 5 segments.

Looking next to fourth quarter revenue and operating income. On a combined basis, the fitness, aviation, marine and outdoor segments contributed 89% of total revenue in the fourth quarter 2019 compared to 84% in the prior year quarter. Fitness grew from 30% to 34%. Aviation grew from 17% to 18%.

Let's see these charts to illustrate our profit mix by segment. Fitness, aviation, marine and outdoor segments collectively delivered 99% of operating income in the fourth quarter of 2019 compared to 97% in the fourth quarter of 2018. All segments besides the auto segment had year-over-year increases in operating income dollars.

Looking next to full year charts. For the full year, fitness, aviation, marine and outdoor segments made up 85% of total revenue compared to 81% in 2018. All segments had year-over-year increases in operating income dollars.

Looking next to operating expenses. Fourth quarter operating expenses increased by $36 million or 11%. Research and development increased $17 million year-over-year due to investments in engineering resources, incremental costs associated with recent acquisitions.

Our advertising expense increased approximately $8 million from the prior year quarter due to higher fitness and outdoor expenses, represented 5.7% of sales, 20 basis point decrease compared to prior year. SG&A increased $12 million compared to prior year quarter but decreased as a percentage of sales to 12.5%, 100 basis point decrease compared to prior year. Increase was primarily due to personnel-related expenses, incremental costs associated with the recent acquisitions.

A few highlights on the balance sheet, cash flow statement and dividend payments. We ended the quarter with cash and marketable securities of $2.6 billion. Accounts receivable increased sequentially year-over-year to $707 million due to strong sales in the holiday quarter. Inventory balance increased year-over-year to $753 million. Increase is due to our strategy to increase data supply to support our increasingly diversified product lines and the acquisition of Tacx.

During the fourth quarter 2019, we generated free cash flow of $208 million. For the full year 2019, we generated free cash flow of approximately $581 million, $183 million decrease from the prior year due to increased working capital needs.

For 2020, we expect free cash flow to be approximately $750 million, approximately $225 million of capital expenditures. We announced our plans to seek shareholder approval for an increase in our dividend beginning with the June 2020 payment. Proposal, the cash dividend of $2.44 per share or $0.61 per share per quarter, it's a 7% increase from the current quarterly dividend of $0.57 per share.

For full year 2019, we reported income tax expense of $35 million, which includes an income tax benefit of $118 million due to revaluation and step-up of certain Switzerland deferred tax assets as a result of the Switzerland tax reform. Excluding the $118 million income tax benefit, the full year 2019 pro forma effective tax rate was 15.5%, 20 basis point decrease from the prior year.

The fiscal year 2020 forma effective tax rate is expected to decrease to 10%, primarily due to the migration of intellectual property ownership from Switzerland to United States. Taking into consideration the recent major tax reform in Switzerland and United States, the migration maintained an efficient tax structure and responds to the changing global tax landscape. Migration includes an intercompany license agreement that shifts intellectual property ownership for our consumer products from Switzerland to United States through royalty payments. This results in a favorable shift of income by jurisdiction, reduces our level expense related to uncertain tax positions. And at the multiyear license agreement, higher percentage of income were recognized in the United States, which concludes our formal remarks.

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

Teri Seck ***Garmin Ltd. - Manager of IR***
Thanks, everyone. As always, Doug and I are available for calls throughout the day. We hope you have a wonderful day. Bye.

Operator
Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day. You may now disconnect.
