Garmin Ltd (Q2 2020 Earnings)
July 29, 2020

Corporate Speakers:

- Teri Seck; Garmin Ltd.; Manager of IR
- Cliff Pemble; Garmin Ltd.; President & CEO
- Doug Boessen; Garmin Ltd.; CFO & Treasurer

Participants:

- Paul Chung; JPMorgan Chase & Co.; Analyst
- Nik Todorov; Longbow Research LLC; Analyst
- Ben Bollin; Cleveland Research Company; Analyst
- Will Power; Robert W. Baird & Co.; Analyst
- Charlie Anderson; Colliers Securities LLC; Analyst
- Erik Woodring; Morgan Stanley; Analyst

PRESENTATION

Operator^ Good morning, ladies and gentlemen. Welcome to the Garmin Ltd. Second Quarter 2020 Earnings Call.

(Operator Instructions)

As a reminder, this conference might be recorded.

I would now like to turn the conference over to your host, Ms. Teri Seck. Ma'am?

Teri Seck^ Good morning. We would like to welcome you to Garmin Ltd. Second Quarter 2020 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/doc. 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, gross margins, operating margins, future dividends, market shares, product introductions, future demand for our products and plans and objectives and the future impact of actual or potential cyber attacks 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 has been contained in our Form 10-K and second quarter 2020 Form 10-Q filed with the Securities and Exchange Commission.

In particular, there is significant uncertainty about the duration and impact of the COVID-19 pandemic.

This means that results could change at any time, and any statement about the impact of COVID on the company's business results and outlook is the best estimate based on the information available as of today's date.

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 Pemble^ Thank you, Teri. Good morning, everyone.

As announced earlier today, Garmin reported strong second quarter financial results during a period of extreme uncertainty created by the COVID-19 pandemic.

As reported last time, the onset of the coronavirus pandemic and measures taken to control the spread of the virus had a significant impact on the economy, on retailers and our consumers. The month of April was particularly challenging for every business, including Garmin. However, conditions steadily improved, and we ended the quarter with significant growth momentum.

Consolidated revenue came in at $870 million, down only 9% on a year-over-year basis. We experienced strong growth from certain online channels, including garmin.com, which partially offset weakness from retailers who were disrupted during the early phases of the pandemic. We also delivered strong profitability. Gross margin was 59.3%. Operating margin was 21.7%, with operating income of $188 million for the quarter. This resulted in GAAP EPS of $0.96 and pro forma EPS of $0.91 for the quarter. Doug will provide additional financial details in a moment, but first, I'd like to make a few remarks on the performance of our business segments.

Starting with the fitness segment, revenue increased 17%, driven by strong consumer interest in health and fitness. Sales of advanced wearables and cycling products were very strong in the quarter. Gross and operating margins were 53% and 24%, respectively.

We recently acquired Firstbeat Analytics, our long time partner and leading provider of physiological analytics technology for health, fitness and athletic performance. This acquisition will help us achieve even greater levels of innovation that will benefit consumers. Looking forward, we expect that the interest in health and fitness will remain very strong. We are ready to see this opportunity with a great lineup of new products with more new products on the way.

Looking next at marine. Revenue increased 4% as boating and fishing became popular pastimes during the pandemic. Many boat builders were idle during the quarter, which tempered our growth, but retail sales were very strong, led by chartplotters and Panoptix sonars. Gross and operating margins were 59% and 28%, respectively. During the quarter, we launched quatix solar, our first marine smartwatch featuring solar charging technology. Looking forward, interest in our marine products remains very strong. We anticipate an extended marine season this year as boaters maximize their time on the water and boat builders work through production backlogs. Additionally, we intend to leverage our compelling product lineup to capture additional market share.

Turning next to the outdoor segment. Revenue decreased 2%. Weakness in traditional handheld categories was mostly offset by growth in adventure watches. Gross margin and operating margin were 65% and 33%, respectively. We recently incorporated solar charging technology into the fenix 6, the 6S, the Instinct line and tactix Delta smartwatches. The Instinct Solar sets a new standard in low power technology by achieving unlimited smartwatch operation using only the energy harvested from the sun. We expect that our solar harvesting technology will be a significant differentiator for us in the smartwatch market. Interest in adventure and outdoor activity remains very strong. We are ready to seize this opportunity with a great lineup of recently introduced products with more new products and new categories on the way.

Turning next to the aviation segment. Revenue decreased 31% as the pandemic created economic uncertainty that negatively impacted OEM partners and retrofit activity. In addition, sales of ADS-B products rapidly declined, as we expected, after the U.S. mandate passed and the market matured. Gross and operating margins were 73% and 12%, respectively. During the quarter, Autoland was certified, marking the beginning of a new era for general aviation safety technology. Autoland is already available and flying on the Piper M600 and Daher TBM 940, and additional certifications are on the way. For the remainder of the year, we anticipate aviation will continue to face challenging headwinds. However, we remain confident in the long-term outlook for this segment as interest in general aviation remains high and we are prepared with a strong lineup of products for every aircraft application. In addition, we believe that advanced safety technologies such as Autoland will make general aviation accessible to more people, which in turn is expected to grow the market.

Finally, for the auto segment, revenue decreased 46% as automakers idled their factories and driving activity decreased significantly. Gross margin was 47%, with an operating loss of $10 million in the quarter, driven by the investment we are making to complete several significant programs. Specialty RV and truck categories were a bright spot during the quarter. We launched several products, including new diesel navigators with oversized displays and enhanced routing features and our new RV 890 navigator designed specifically for the needs of the RV and camping lifestyle. Looking forward, we anticipate that revenue from OEM products will grow in the back half of the year as we complete several OEM programs. Additionally, we continue to invest in specialty products and expect to enter new market verticals soon.

And finally, most of you are aware of the recent cyber attack that led to a network outage affecting much of our website and consumer-facing applications. We immediately assessed the nature of the attack and started remediation efforts. We have no indication that any customer data was accessed, lost or stolen. Additionally, the functionality of Garmin products was not affected other than the ability to access some online services. Critical affected business systems have been restored, and we expect to restore remaining systems in the coming days. We appreciate the patience and kind words of support we've received from customers and friends during this challenge.

So that concludes my remarks. Next, Doug will walk us through additional details on financial results. Doug?

Doug Boessen^ Thanks, Cliff. Good morning, everyone. I'll begin by reviewing our second quarter financial results, move to comments on the balance sheet, cash flow statement and taxes. We posted revenue of $870 million for the second quarter, representing a 9% decrease year-over-year. Gross margin was 59.3%, 100 basis point decrease in the prior year. Operating expense as a percentage of sales was 37.6%, a [220] basis point increase from the prior year. Operating income was $188 million, a 26% decrease year-over-year. Operating margin was 21.7%, a 510 basis point decrease from the prior year. Our GAAP EPS was $0.96. Pro forma EPS was $0.91.

Next, we look at our second quarter revenue by segment. We achieved revenue of $870 million with 2 of our 5 segments posting growth, led by the fitness segment with strong revenue growth of 17%. As seen in the charts, we have a diversified business model from both a segment and geography perspective.

Looking at our year-to-date revenue for the first 6 months of 2020. Our consolidated revenue was flat to the prior year, with 2 of our segments posting growth, led by fitness with 20% growth; marine, with 12% growth. Our geography, EMEA is up 6%; Americas is flat compared to the prior year.

Looking next, operating expenses. Our second quarter operating expenses increased by $8 million or 2%. Research and development increased $17 million year-over-year, primarily due to investments in engineering resources. Advertising expenses decreased approximately $12 million from the prior year quarter due to lower media spend. SG&A increased $3 million compared to the prior year quarter, primarily due to increases in 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 and no debt. Accounts receivable increased sequentially to $524 million, but decreased year-over-year in line with second quarter sales. Inventory balance increased on both a sequential year-over-year basis due to our strategy to increase data supply, sport increasingly diversified product lines, timing of product launches, the transition to a higher percentage of ocean shipments compared to air.

In the second quarter of 2020, we generated free cash flow of $142 million, $62 million increase from the prior quarter. In the second quarter 2020, we report an effective tax rate of 6.8%. Excluding the impact of a $14 million income tax benefit due to the release of uncertain tax position reserves associated with the 2014 intercompany restructuring, our pro forma effective tax rate was 14% compared to 18.9% in the prior year quarter. The decrease is primarily due to intellectual property migration transaction.

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

Have a great day.

Operator^ Ladies and gentlemen, this concludes today's conference. Thank you all for your participation.

Have a wonderful day. You may all disconnect.