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EDITED TRANSCRIPT

Q3 2020 Garmin Ltd Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Garmin Limited Third Quarter 2020 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 to your speaker today, Teri Seck, with Investor Relations. Please go ahead, ma'am.

Teri Seck *Garmin Ltd. - Manager of IR*

Good morning. We would like to welcome you to Garmin Limited's Third 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/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 Limited 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 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 and third 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-19 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 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. Earlier today, Garmin reported record third quarter operating results. Consolidated revenue exceeded \$1.1 billion, as strong demand for active lifestyle products fueled growth of 19% over the prior year. Gross margin was 60.2%. Operating income increased 21% year-over-year to \$317 million and operating margin expanded to 28.6%. This resulted in GAAP EPS of \$1.63 and pro forma EPS of \$1.58 for the quarter, up 24% over the prior year.

We are pleased with our performance so far in 2020, especially considering the unprecedented challenges caused by the COVID-19 pandemic. Trends in the business are stabilizing, which gives us confidence to provide fiscal 2020 guidance, which I will cover shortly. First, I'd like to offer a few remarks on the performance of each of our business segments.

Starting with marine. Revenue increased 54%, as we experienced growth in multiple product categories, led by strong demand for chartplotters. Gross and operating margins were 61% and 31%, respectively, resulting in operating income growth of over 150%. There are 2 key factors driving these results. First, the market is expanding as new customers embrace boating and fishing. Second, our strong lineup of products and game-changing technologies are driving market share gains.

We continue to be recognized for our innovation and achievements in the marine industry. For the sixth consecutive year, the National Marine Electronics Association named Garmin Manufacturer of the Year and we received 4 Product of Excellence awards. We were also recognized as one of the top 10 most innovative marine companies by Soundings Trade Only, a B2B news and information provider for the recreational boating industry.

Looking forward, we anticipate that interest in boating and fishing will remain strong. We plan to capitalize on these trends by offering a compelling lineup of products with innovative features and disruptive technologies.

Turning next to the fitness segment. Revenue increased 35%, driven by strong demand for advanced wearables and cycling products. Gross and operating margins were 54% and 27%, respectively, resulting in operating income growth of 75% over the prior year. The pandemic continues to highlight the importance of living a healthy life, and our fitness segment benefited from this trend.

During the quarter, we launched the new Forerunner 745, expanding the features offered in our mid-tier

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multisport product range. We also launched Clipboard, an app that facilitates team training and performance monitoring using Garmin devices.

In the advanced wellness category, we launched the Venu Sq, an entry-level smart watch that combines daily wear style with industry-leading activity tracking and health monitoring features.

Looking forward, we expect a broader trends in fitness and wellness to continue. We plan to leverage our recent acquisition of Firstbeat to offer products with unique health, wellness and fitness features. In addition, we intend to capitalize on the indoor cycling opportunity with our Tacx product line.

Turning next to the outdoor segment. Revenue increased 30% with strength in all major categories, led by strong demand for adventure watches. Gross and operating margins were 67% and 44%, respectively, resulting in 40% operating income growth. The segment benefited from increased consumer interest in outdoor activities.

inReach is an important technology that provides critical emergency and communication services in places where cell phones simply don't work. We recently added inReach to our popular Montana series, and we announced that inReach has facilitated over 5,000 SOS incidents since its launch in 2011. This is a significant milestone, reflecting the important role inReach technology can play in changing outcomes.

Looking forward, we expect the broader trends in outdoor to continue. We plan to leverage this opportunity by offering unique products that maximize the enjoyment of outdoor activity and adventure.

Turning next to the auto segment. Revenue decreased 6% as the decline in consumer P&D was partially offset by growth in specialty categories and revenue from new OEM programs. Gross and operating margins were 45% and 3%, respectively. The Auto segment continues to transform as we launch new specialty products, like the Garmin Catalyst, an industry first real-time coaching tool designed to optimize track racing performance. New OEM projects are also making contributions and will further diversify the revenue mix in the segment.

During the quarter, we began production shipments of the MGU 2020 computing module, marking the beginning of our relationship with BMW automobiles as a Tier 1 supplier. In addition, we began shipments of the complete infotainment solution for the Daimler Vito van.

Looking forward, we will continue to pursue growth opportunities in specialty product categories. In addition, we will be making major investments to complete OEM projects we have won in recent years, and we will continue to pursue new opportunities as a Tier 1 supplier of innovative electronic solutions for a broad range of vehicles.

Looking finally at the aviation segment, revenue decreased 19% due to lower revenue from OEM product categories and the expected decline of the ADS-B market. Gross and operating margins were 71% and

19%, respectively. While the OEM market has experienced some headwinds, we see positive signs in the smaller aircraft segment, especially in owner flown aircraft. In addition, when adjusting for the impact of ADS-B, we see encouraging sign lines in the retrofit market as aircraft owners take advantage of the latest cockpit technologies.

During the quarter, Autoland achieved FAA certification on the Cirrus Vision Jet, which is the first jet aircraft to incorporate Autoland technology. This latest certification brings the Autoland equipped aircraft to 3 models, including the previously certified Piper M600 and the Daher TBM 940.

Autoland is receiving notable recognition as an important new safety technology for general aviation. And Aviation Week Network recently selected Autoland as the Grand Laureate Winner for its achievement in the category of business aviation.

Looking forward, we believe that the general aviation market will stabilize as impacts from the pandemic, the associated economic fallout, and the ADS-B mandate began to fade. We will continue to invest in compelling new products and technology in anticipation of the next chapter of growth for the general aviation market.

In summary, I'm very proud of what Garmin associates have accomplished so far in 2020, while facing circumstances that no one could have anticipated just 1 year ago. Considering our growing confidence and business trends, we are issuing full year 2020 guidance. We now project revenue of approximately \$4 billion as growth in marine, fitness and outdoor more than offset the expected declines in aviation and auto. We anticipate gross margin of approximately 59% and operating margin of approximately 24%, assuming a pro forma effective tax rate of 10%, pro forma earnings per share are expected to be approximately \$4.70.

Looking at full year 2020 revenue guidance by segment. We expect the marine segment to grow 25%, the fitness segment to grow 20% and the outdoor segment to grow 15%. We expect the aviation segment to decline 17% and the auto segment to decline 20%.

So that concludes my remarks this morning. Next, Doug will discuss additional details on our financial results. Doug?

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

Thanks, Cliff. Good morning, everyone. I'd begin by reviewing our third quarter financial results, move comments on the balance sheet, cash flow statement and taxes. We posted record revenue over \$1.1 billion for the third quarter, representing 19% growth year-over-year. Gross margin was 60.2%, a 50 basis point decrease from the prior year.

Operating expense as a percentage of sales was 31.6%, 110 basis point decrease from the prior year.

Operating income was \$317 million, a 21% increase year-over-year. Operating margin was 28.6%, 60

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basis point increase from the prior year. Our GAAP EPS was \$1.63 and pro forma EPS was \$1.58, a 24% increase from the prior year period.

Next, we look at our third quarter revenue by segment. We achieved revenue of over \$1.1 billion with 3 of our 5 segments posting growth of 30% or more, led by the marine segment with robust revenue growth of 54%. By geography, we achieved 19% growth in Americas, EMEA and APAC.

Looking at our year-to-date revenue for the first 3 quarters of 2020. Our consolidated revenue is up 7% with the prior year with 3 of our 5 segments posting double-digit growth, led by the fitness segment, with 25% growth, followed closely by marine segment with 24% growth.

Looking next, operating expenses. Our third quarter operating expenses increased by \$45 million or 15%. Research and development increased \$26 million year-over-year, primarily due to investments in engineering resources. Our advertising expense increased by approximately \$1 million due to higher spend in our outdoor segment. SG&A increased \$17 million compared to prior year quarter, primarily due to increases in information technology costs and personnel-related expenses.

Let me highlight 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 \$658 million, and increased year-over-year in line with third quarter sales. Inventory balance increased on both a sequential and year over year basis to prepare for the seasonally strong fourth quarter, support our increasingly diversified product lines.

During the third quarter of 2020, we generated free cash flow of \$236 million, a \$78 million increase from the prior year quarter. For full year 2020, we expect free cash flow to be approximately \$750 million, approximately \$175 million of capital expenditures. Also during the quarter, we paid dividends of \$117 million.

During third quarter 2020, we reported an effective tax rate of 6.9% compared to the effective tax rate of 11.6% in the prior year quarter. The decrease is primarily due to intellectual property migration transaction. We expect our full year 2020 pro forma effective tax rate to be approximately 10%.

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

Teri Seck *Garmin Ltd.* - Manager of IR

Thank you all for joining us today. Doug and I are available for callbacks. Have a wonderful day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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