Garmin Ltd. (Q4 2020 Earnings)

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Corporate Speakers:

- Teri Seck; Garmin Ltd.; Manager of IR
- Clifton Pemble; Garmin Ltd.; President, CEO & Director
- Douglas Boessen; Garmin Ltd.; CFO, Principal Accounting Officer & Treasurer

Participants:

- Robert Spingarn; Credit Suisse AG; Aerospace and Defense Analyst
- Nikolay Todorov; Longbow Research LLC; Analyst
- Paul Chung; JPMorgan Chase & Co; VP & IT Hardware Analyst
- Benjamin Bollin; Cleveland Research Company; Senior Research Analyst
- Jeffrey Rand; Deutsche Bank AG; Research Associate
- William Power; Robert W. Baird & Co. Incorporated; Senior Research Analyst
- Ronald Epstein; BofA Securities; Industry Analyst
- Ivan Feinseth; Tigress Financial Partners LLC; Director of Research
- Erik Woodring; Morgan Stanley; Research Associate

PRESENTATION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Garmin Ltd. Fourth Quarter 2020 Earnings Conference Call. (Operator Instructions)

I would now like to hand the conference to your speaker today, Teri Seck, Manager of Investor Relations. Please go ahead, ma'am.

Teri Seck: Good morning. We would like to welcome you to Garmin Ltd.'s Fourth 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 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 margin, 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 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 in 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, and good morning, everyone. As reported earlier today, our growth momentum accelerated in the final quarter of the year. Revenue increased 23%, exceeding $1.3 billion, driven by strong double-digit growth in our fitness, outdoor and marine segments. Gross margin improved to 58.5%. Operating income increased 34% to $371 million, and operating margin expanded to 27.5%. GAAP EPS was $1.73 and pro forma EPS was also $1.73, increasing 34% over the prior year.

Looking back, I'm very proud of what we accomplished in 2020. The COVID-19 pandemic created unprecedented challenges affecting every company. And of course, Garmin was no exception. Many of these challenges were the burden of employees, such as learning to work and collaborate remotely, while juggling new challenges in their personal lives. Our employees were very resilient and faced these challenges with courage and determination as reflected in our outstanding performance throughout the year.

The pandemic also created many new opportunities as interest in health, fitness and active lifestyles surged. We were well positioned to seize these opportunities with a strong product lineup, and our vertically integrated business model gave us flexibility to meet rapidly changing demands. During this crisis, we maintained our focus on R&D, which allowed us to introduce many innovative new products throughout the year.

On a consolidated basis, revenue increased 11% to nearly $4.2 billion, which is a new record for Garmin, and our fifth consecutive year of growth. Gross margin was 59.3%, and operating margin was 25.2%. Operating income increased 11% to over $1 billion, which is another record achievement.

This resulted in GAAP EPS of $5.17 and pro forma EPS of $5.14, an increase of 16% over the prior year. Considering these strong results at our upcoming annual meeting, will ask shareholders to approve an annual dividend of $2.68 per share, representing a 10% increase over the current annual dividend amount.

Doug will discuss our financial results in greater detail in a few minutes. But first, I'd like to highlight some achievements from the past year and the outlook for each of our 5 business segments.

Starting with the fitness segment. Revenue increased 26% as strong demand for advanced wearables and cycling products fueled our growth. Growth in operating margins were 53% and 24%, respectively, resulting in operating income growth of 66% over the prior year. During the year, we launched innovative new wearables and cycling products, such as the Venue Sq and Forerunner 745 and the next-generation of Edge cycling computers.

Looking forward, we are well positioned to capitalize on the broader trends in health and fitness. We plan to leverage our recent acquisition of first speed to offer products with unique health and fitness features. In addition, we intend to capitalize on the trends in indoor cycling with our strong lineup of Tacx products. With these things in mind, we anticipate revenue from the fitness segment will increase approximately 10% in 2021.

In the outdoor segment, revenue increased 23%, primarily driven by strong demand for adventure watches. Gross and operating margins were 66% and 39%, respectively, resulting in operating income growth of 32%. During the year, we added solar charging technology to a broad range of fēnix and Instinct models, extending our lead in low power technology and further differentiating ourselves in the highly competitive smartwatch market.

Looking forward, we expect the broader trends in outdoor to continue. We plan to leverage this opportunity by offering compelling products that maximize the enjoyment of outdoor activity and adventure. We believe that inReach will continue to grow as more people appreciate the convenience and life-saving potential of 2-way remote communication.

Our recent acquisition of GEOS, a critical provider of emergency monitoring and incident response services, allows us to expand its scale and improve service levels for our growing base of inReach customers. With these things in mind, we anticipate revenue from the outdoor segment will increase approximately 10% in 2021.

Looking next at the aviation segment, revenue decreased 15% due to lower revenue from OEM product categories and the expected decline of the ADS-B market. Gross and operating margins were 73% and 22%, respectively.

While the pandemic created some headwinds, particularly in the OEM market, we see positive signs in the smaller aircraft segment, especially in owner-flown aircraft. In addition, when adjusting for the impact of ADS-B, there are encouraging signs in the aftermarket as aircraft owners embrace the latest cockpit technologies.

Autoland is being recognized as game-changing new safety technology for general aviation, and recently was named 1 of 2020 greatest innovations by Popular Science. Autoland also won a top flight award from Aviation International News. During the year, Autoland achieved certification on 3 aircraft models, including the Cirrus Vision Jet, the Piper M600 and the Daher TBM 940. Over 150 Autoland equipped aircraft are now in service, a number that continues to grow every day.

We believe the general aviation market is stabilizing. And during 2021, we expect this segment to grow approximately 5% with contributions from both OEM and aftermarket categories.

We expect revenue from the segment to decline in the first quarter as we compare against strong residual ADS-B numbers from last year, followed by growth as the year-over-year comparisons become much more favorable. We are focused on certifying safety enhancing technologies such as Autoland and additional aircraft models, and we will continue to invest in future growth opportunities.

Moving on to marine. The segment delivered another year of impressive results, as the pandemic created an opportunity for people to rediscover boating and fishing. Revenue increased 29%, with growth in multiple product categories, led by strong demand for chartplotters.

Gross and operating margins were 58% and 27%, respectively, resulting in operating income growth of 60%. We continue to be recognized for innovation and achievement in the marine industry. We were named supplier of the year by Independent Boat Builders, Inc; manufacturer of the year by the National Marine Electronics Association; and recently, we were recognized as 1 of the top 10 most innovative marine companies by Soundings Trade Only, which is a B2B news and information provider for the recreational boating industry.

Looking forward, we anticipate that interest in boating and fishing will remain strong. Many boat builders have already sold out of their 2021 models, and our retail partners are preparing for another year of strong growth. We plan to capitalize on these trends by offering a compelling lineup of products with innovative features and disruptive new technologies. With this in mind, we anticipate revenue from the marine segment will increase approximately 15% in 2021.

Moving finally to the auto segment. I want to highlight that we are now providing expanded disclosures for the segment. Specifically, we are disclosing separate financial information for the 2 operating segments within auto: the consumer segment, which includes PND and specialty products; and the OEM segment, which is focused on hardware and software solutions for vehicle manufacturers. We believe these expanded disclosures will help investors better understand the mix of revenue, the level of investment and the profit profile of each profit segment.

Now looking at the year-end results for the auto segment. Revenue decreased 16% as the decline in PNDs was partially offset by growth in specialty products and revenue from new OEM programs. Gross margin was 35%, and we recorded an operating loss of $19 million, driven by investments in auto OEM programs.

Our auto OEM business has reached an inflection point as we ramp up new programs over the next few years. Prior to the most recent wins, we have been successful on various software, navigation and infotainment programs with several top-tier OEMs, such as Honda, Toyota, Daimler and Peugeot, to name just a few.

We are currently in production with a full infotainment system for the Daimler Vito van, and we recently began production on the current BMW program, where we are a Tier 1 build-to-print supplier. Also, we are developing the next-generation program for BMW as the lead supplier, which expands our role to encompass all aspects of the design, including hardware, complex operating system development and system integration.

Moving into this lead supplier role on future programs is a testament to the progress we've made as a Tier 1 supplier to the auto industry. These programs require a significant investment in R&D prior to realizing revenue, and not all costs are reimbursed by the customer.

With these things in mind, we expect total auto revenue to grow approximately 5% in '21, driven by growth in specialty consumer products and new OEM programs. We also expect additional losses from the OEM operating segment as we invest in the development of future programs expected to launch in late 2022.

Well, in summary, I'm very proud of what we accomplished in 2020, while facing challenges that no one could have anticipated just 1 year ago. The indicators for 2021 look positive, and we are excited about the opportunities in every business segment.

With this in mind, we anticipate 2021 revenue will be approximately $4.6 billion, an increase of 10% over the prior year, and we anticipate growth in all segments. We expect gross margin to be approximately 59.2% and operating margin at approximately 23.5%. Assuming a pro forma effective tax rate of 10.5%, pro forma earnings per share are expected to be approximately $5.15.

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

Douglas Boessen: Thanks, Cliff. Good morning, everyone. I'll begin by reviewing our fourth quarter and full year financial results, move to comments on the balance sheet, cash flow statement and taxes.

We posted revenue over $1.3 billion for the fourth quarter, representing a 23% increase year-over-year. Gross margin was 58.5%, a 50 basis point increase in the prior year. Operating expense percentage of sales was 31.1%, a 180 basis point decrease. Operating income was $371 million, a 34% increase. Operating margin was 27.5%, 240 basis point increase in the prior year. Our GAAP pro forma EPS was $1.73, 34% increase from the prior year pro forma EPS.

Looking at full year results, we pose revenue of over $4.1 billion, representing 11% increase year-over-year. Gross margin was 59.3%, a 20 basis point decrease from the prior year. Operating expense percentage of sales was 34.1%, a 20 basis point decrease.

Operating income was $1.054 billion, a 7% increase. Operating margin was 25.2%, consistent with the prior year. Our GAAP EPS was $5.17 per EPS of $5.14, 16% increase from the prior year.

Next, looking at fourth quarter revenue by segment and geography. In our fourth quarter, we achieved double-digit growth for our 5 segments, led by marine segment, the growth of 48%; followed by the outdoor segment, 40% growth to fitness segment for 26% growth. By geography, we achieved growth in all 3 regions, led by strong growth, 32%, both EMEA and APAC.

Americas grew 13%, which is more heavily impacted by the decline in aviation. Excluding aviation, Americas' growth was more in line with other regions. For the full year 2020, we achieved 11% consolidated growth with strong double-digit growth in 3 of our 5 segments. Marine, fitness and outdoor each grew in excess of 20%. On geography, we achieved growth in all 3 regions, led by 17% growth, EMEA, 8% growth, both Americas and APAC.

Looking next, operating expenses. Fourth quarter operating expenses increased by $57 million or 16%. Research and development increased $38 million year-over-year, primarily due to engineering personnel costs their expenses related to auto OEM programs. Our advertising expense decreased approximately $2 million for the prior year quarter. SG&A increased $21 million compared to prior year quarter, a decrease percentage of sales to 11.8%, a 70 basis point decrease compared to the prior year. The increase in SG&A is primarily due to increases in Information Technology costs personnel-related expenses.

A few highlights on the balance sheet, cash flow statement and dividends. We ended the quarter with cash and marketable securities of approximately $3 billion. Accounts receivable increased sequentially year-over-year to $849 million due to strong sales in the fourth quarter. Inventory balance increased year-over-year to $762 million. During the fourth quarter 2020, we generated free cash flow of $387 million.

For the full year 2020, we generated free cash flow of approximately $950 million, $369 million increase from the prior year due to improved earnings decreased operating capital needs. For 2021, we expect free cash flow to be approximately $725 million, approximately $350 million of capital expenditures.

Expected year-over-year increase capital expenditures due to investments in platforms for growth, including expansion of our Taiwan manufacturing facilities, restarting the late expansion project, which includes the renovation of the previous [Aleta] manufacturing and distribution facility to increase workspace capacity, the auto OEM manufacturing facility in Europe and IT-related projects.

We announced our plans to seek shareholder approval for an increase in our dividend beginning with the June 2021 payment. Proposal is a cash dividend of $2.68 per share or

$0.67 per share for the quarter. This is a 10% increase from our current quarterly dividend of $0.61 per share.

For full year 2020, we reported an effective tax rate of 10.1%. Former effective tax rate is 10.4%, 510 basis point decrease from the prior year, primarily due to the migration intellectual property ownership in Switzerland to United States. The fiscal year 2021 pro forma effective tax rate expected to be 10.5%, relatively flat year-over-year.

This concludes our formal remarks.

Teri Seck: Thank you, everyone, for joining us today. Doug and I are available for callbacks, and we will talk with a lot of you in the coming days and weeks. Have a great day. Bye.

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