Garmin Ltd.(Q1 2022 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 & Treasurer

Participants:

- Paul Chung; JPMorgan Chase & Co; Research Division, VP & IT Hardware Analyst
- William Power; Robert W. Baird & Co. Incorporated; Research Division, Senior Research Analyst
- Nikolay Todorov; Longbow Research LLC; Analyst
- Jeffrey Rand; Deutsche Bank AG; Research Division, Research Associate
- Benjamin Bollin; Cleveland Research Company LLC; Senior Research Analyst
- Elizabeth Grenfell; BofA Securities; Research Division, Analyst
- Erik Woodring; Morgan Stanley; Research Division, Research Associate

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to Garmin Limited First Quarter 2022 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 first speaker today to Teri Seck, Director of Investor Relations. Please go ahead.

Teri Seck^ Good morning. We would like to welcome you to Garmin Ltd.'s First Quarter 2022 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 margins, operating margins, future dividends or share repurchases, 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 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, and good morning, everyone. As reported earlier today, consolidated revenue increased 9% to $1.17 billion, representing a new first quarter record. Four business segments reported revenue growth in the quarter, 3 of which delivered double-digit growth.

We generated $229 million of operating income, down 8% from the prior year. Operating margin was 19.5% and was negatively impacted by gross margin performance, which declined due to historically high freight costs, combined with the strengthening of the U.S. dollar. In addition, operating expenses increased for a variety of reasons, including higher associate head count, increased compensation costs and the increase of certain operational expenses as business activities continue to normalize.

We performed very well during the quarter despite a combination of old and new headwinds. Supply chain constraints persist, which limited the orders we could fill. Russia's invasion of Ukraine created an unthinkable humanitarian crisis and further complicated the global economic outlook. Despite these challenges, demand for our products remains strong and we are optimistic about the future.

Our Board of Directors recently approved a $300 million share repurchase plan, which is in addition to the proposed $2.92 per share dividend that will be considered by shareholders at the upcoming annual meeting. Before turning the call over to Doug, I'll provide highlights by segment and a summary of what we see ahead.

Starting with business, revenue decreased 28% to $221 million. Gross and operating margins were 48% and 0%, respectively. All product categories declined, but the normalization of demand for cycling products was the main contributor. While revenue from fitness wearables declined, on a combined basis, wearable device revenue across all segments at Garmin experienced robust growth.

We expected the first half of the year to be challenging for the fitness segment as we compare against the outstanding performance of the prior year. While the decline was greater than expected, we believe these trends will moderate in the back half of the year as we move past the pandemic swings of 2021 and benefit from new product introductions.

Moving to the outdoor segment. Revenue increased 50% to $385 million with growth in multiple categories led by strong demand for adventure watches. Gross and operating margins were 64% and 39%, respectively, resulting in operating income of $149 million.

During the quarter, we announced sweeping updates to our adventure watch lineup, including our flagship fenix 7 series featuring a distinctive new design with a touchscreen display, and the Instinct 2 series available in 2 sizes, including versions that can operate indefinitely using our exclusive solar power technology.

We also announced the all-new epix with a bright AMOLED touchscreen display and class-leading battery life up to 16 days. We believe that strong demand for these new products as well as other categories in the segment will be a growth driver for the remainder of the year.

Looking next at the aviation segment. Revenue increased 1% to $175 million with growth driven by OEM product categories. Supply constraints impacted sales of aftermarket products but the situation improved throughout the quarter. Gross and operating margins were 73% and 23%, respectively, resulting in operating income of $40 million.

Aircraft OEMs are reporting robust orders from both new and existing customers. Aftermarket demand is also strong as customers invest in new cockpit systems. We believe these are positive indicators of growth for the remainder of the year.

The marine segment delivered another quarter of impressive results with revenue increasing 21% to $254 million. We experienced broad-based growth across multiple product categories led by chartplotters. Gross and operating margins were 51% and 23%, respectively, resulting in operating income of $59 million.

LiveScope has proven to be a halo technology for Garmin, and the new LiveScope Plus sonar system raises the bar with higher resolution images and improved target separation. We continue to see strong demand for our marine products and LiveScope Plus builds on this momentum. We believe this is a positive indicator of growth for the remainder of the year.

Moving finally to the auto segment. Revenue increased 11% to $138 million, with growth from both OEM and consumer categories. Gross margin was 38%, and we recorded an operating loss of $20 million driven by investments in auto OEM programs.

In consumer auto, we continue to diversify our product offerings with the launch of the Instinct 2 dezl edition smartwatch for truck drivers. In the OEM category, we made significant progress preparing for the launch of the next-generation BMW computing module platform. BMW approved our new Poland factory, giving it a rare green rating for mass production readiness. We anticipate delivering production parts to BMW starting in the second quarter.

Before I turn the call over to Doug, it's important to remember that our diversified business model offers many different paths to achieve our consolidated growth goals. We remain focused on creating highly differentiated products in all segments that excite our customers and lead to success.

Regarding our outlook for the rest of the year, I mentioned several new and existing headwinds we face, and we cannot predict the impact that these might have on the business.

Also, the first quarter represents the lowest seasonal quarter of our financial year and much of the year remains ahead of us. With these things in mind, we are maintaining our 2022 guidance issued in February, which called for consolidated revenue of $5.5 billion and EPS of $5.90 a share. So that concludes my remarks. Next, Doug will walk you through additional details on our financial results. Doug?

Douglas Boessen^ Thanks, Cliff. Good morning, everyone. I begin by reviewing our first quarter financial results and provide comments on the balance sheet, cash flow statement and taxes.

We posted revenue of $1.173 billion in the first quarter, representing 9% increase year-over-year. Gross margin was 56.5%, 330 basis point decrease from the prior quarter. The decrease was primarily due to higher freight costs and favorable impact of foreign exchange rates.

Operating expense as a percentage of sales was 37%, a 50 basis point increase. Operating income was $229 million, 8% decrease. Operating margin was 19.5%, 300 basis point decrease. Our GAAP EPS was $1.09. The former EPS was $1.11.

Next, we look at our first quarter revenue by segment and geography. In the first quarter, we achieved double-digit growth in 3 of our 5 segments, led by the outdoor segment, robust growth of 50%; followed by the marine segment, 21% growth; and the auto segment, 11% growth. By geography, 21% growth in APAC, 13% growth in Americas was partially offset by 1% decline in EMEA, which was negatively impacted by foreign exchange rates during the quarter.

Looking next at operating expenses. First quarter operating expense increased by $42 million or 11%. Research and development increased $20 million year-over-year, primarily due to engineering personnel costs.

Advertising expense increased approximately $3 million due to higher spend in the outdoor and marine segments. SG&A increased $19 million compared to the prior year quarter, primarily due to increases in personnel-related expenses, information technology costs.

A few highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with cash, marketable securities approximately $3 billion. Accounts receivable decreased sequentially to $600 million following a seasonally strong fourth quarter and grew year-over-year, relatively in line with our sales growth.

Inventory balance increased year-over-year to $1.3 billion. We're executing our strategy, increase days supply to support our increasingly diversified product lines to optimize the mix of ocean versus air freight shipments to carry sufficient levels of raw material safety stock to mitigate increased lead times.

In the first quarter of 2022, we generated free cash flow of $126 million, a $206 million decrease in the prior quarter, primarily due to increased working capital needs and higher capital expenditures, also reported effective tax rate of 10.3% compared to 12.2% in the prior quarter. The decrease in effective tax rate is primarily due to an increase in U.S. tax deductions and credits. This concludes our formal remarks. Talon, could you please open the line for Q&A?

Teri Seck^ Okay, everyone. Thanks so much for your time. Doug and I are available for callbacks and have a great day.

Operator^ This concludes today's conference call. Thank you for participating. You may now disconnect.