Garmin Ltd. (Q2 2022 Earnings)
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Corporate Speakers
- Theresa Seck; Garmin Ltd.; Manager of Investor Relations
- Cliff Pemble; Garmin Ltd.; President, CEO & Director
- Doug Boessen; Garmin Ltd.; CFO & Treasurer

Participants
- Paul Chung; JPMorgan Chase & Co; Analyst
- Ben Bolin; Cleveland Research Company LLC; Analyst
- Nikolay Todorov; Longbow Research LLC; Analyst
- Ivan Feinseth; Tigress Financial Partners LLC; Analyst
- Erik Woodring; Morgan Stanley; Analyst

PRESENTATION

Operator: Thank you for standing by, and welcome to the Garmin Limited Second Quarter 2022 Earnings Conference Call. (Operator Instructions) As a reminder, today's program may be recorded.

And now I'd like to introduce your host for today's program, Theresa Seck, Director of Investor Relations. Please go ahead.

Theresa Seck: Good morning. We would like to welcome you to Garmin Limited's Second 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 Limited and its business. Any statements regarding our financial -- our future financial position, revenues, earnings, gross margins, operating margins, future dividends or share repurchases, market share, 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 results could change at any time. These results and outlook is the best estimate based on the information available as of today's date.

Presenting on behalf of Garmin Limin 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.

Cliff Pemble: Thank you, Teri, and good morning, everyone. As reported earlier today, consolidated revenue came in at $1.24 billion, down 6% from the strong pandemic-driven comparable of 2021. We generated $293 million of operating profit for the quarter, which was down 21% from the prior year, and operating margin was 23.6%.

Our performance in the quarter was influenced by several factors. First, the U.S. dollar strengthened significantly over the prior year relative to other major currencies and unfavorably impacted second quarter revenue by approximately $57 million. Our strategy for managing currency fluctuations of this nature is to increase prices where we are able and reset pricing as we introduce innovative new products. We believe this approach is very effective in managing currency changes over the long term, but the rapid and relentless strengthening of the U.S. dollar will be a significant headwind for the remainder of the year. From a business segment perspective, underperformance in fitness had a significant impact on our results, which I will cover in more detail in just a moment. And finally, we continue to experience supply chain constraints, which limited the orders we could fill in the quarter, specifically in marine and aviation.

Considering our performance so far, we're adjusting expectations for the remainder of the year. We now anticipate revenue of approximately $5 billion, which is flat to the prior year, and EPS of $4.90, representing a year-over-year decline of approximately 16%. This new guidance assumes currency exchange rates stabilize at current levels, and we have adjusted growth expectations for fitness and marine, which reflect the current trends.

Doug will provide more details on our financial results and updated guidance in just a moment, but first, I'll provide highlights on the performance and outlook of each business segment. Starting with fitness, revenue decreased 34% to $272 million. Gross and operating margins were 49% and 9%, respectively, resulting in operating income of $23 million. The second quarter decline was broad-based, impacting all categories in the segment and was primarily driven by demand normalization in the advanced wearable and cycling categories. These are categories which benefited significantly from pandemic fuel demand in the first half of 2021.

Although our Q2 performance was disappointing, we are encouraged by the response to our new product introductions. During the quarter, we celebrated Global Running Day with the launch of 2 new running watches, the Forerunner 255 and the Forerunner 955. The Forerunner 955 solar version is our first running watch with solar charging capability, which provides up to 20 days of battery life in smartwatch mode. We also launched the Edge 1040 cycling computer featuring solar charging capability for superior battery life and multiband GPS technology for accurate, high-performance positioning in the most challenging ride environments, such as those found in urban areas or dense street cover. Given the year-to-date performance and current trends, we now expect fitness revenue to decline 25% for the year.

Moving to outdoor. Revenue increased 18% to $382 million with growth across multiple categories led by adventure watches. Gross and operating margins were strong at 66% and 40%, respectively, resulting in operating income of $154 million. During the quarter, we launched the tactix 7, a premium smartwatch with unique capabilities such as night vision compatibility as well as advanced tactical performance and risk-based navigation features. The outdoor segment has been a strong performer so far, and we are maintaining our revenue growth estimate of 20% for the year.

Looking next to aviation. Revenue increased 13% to $205 million driven by growth in both OEM and aftermarket categories. Gross and operating margins were strong at 72% and 30%, respectively, resulting in operating income of $62 million. During the quarter, supply chain constraints eased bringing back orders down from historically high levels, but we have more work to do to meet the strong demand for our products.

We recently announced that we now have more than 25,000 integrated flight decks in service across a broad range of application, from piston trainers to transcontinental business jets. This achievement demonstrates the unmatched versatility and capability of our integrated flight deck systems. The aviation segment has delivered solid performance so far and we are maintaining our revenue growth estimate of 10% for the year.

Turning next to the marine segment. Revenue decreased 7% to $243 million. Demand for our products was even higher than it was during the historic second quarter of 2021, but we were unable to satisfy all of the demand due to supply chain constraints. Gross and operating margins were 57% and 28%, respectively, resulting in operating income of $69 million.

Since it was first introduced in 2018, our LiveScope sonar system has been a game changer for the inland lake fishing market and has been a growth catalyst for the marine segment. We recently expanded our product lineup with the introduction of the LiveScope XR system, which operates at greater depths and expands the addressable market for live action sonar to coastal and deep lake fishing applications. We're excited to bring live scope technology to the deep fishing market and believe it represents another growth opportunity for the marine segment. Given our performance so far this year and the anticipated return of normal seasonality patterns in the marine market, we will now expect revenue growth of 5% for the year.

Looking finally at auto. Revenue decreased 6% to $139 million with declines in both consumer and OEM categories. Consumer was impacted by lower sales of consumer PNDs, while OEM was impacted by reduced orders from automakers who face their own supply chain challenges. Gross margin was 40%, and we recorded an operating loss of $15 million driven by ongoing investments in auto OEM programs.

During the quarter, we entered a new product category with the launch of our first diesel headset, offering truck drivers high-quality audio, up to 50 hours of continuous talk time, and unique integration features with our diesel navigator units. While the first half of the year has been slightly below expectations, we believe growth will resume in the second half as automaker production improves. As a result, we are maintaining our revenue growth estimate of 5% for the year.

So in closing, while we are facing a variety of headwinds, it's important to remember, our diversified business model provides many opportunities for growth within each segment. We have a very strong product lineup, and more new products are on the way. We remain focused on what we can control, and we'll be agile and opportunistic as we navigate the evolving macroeconomic environment.

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

Doug Boessen: Thanks, Cliff. Good morning, everyone. I'd like to begin by reviewing our second quarter financial results, provide comments on the balance sheet, cash flow statement, taxes and updated guidance. We posted revenue of $1.24 billion for the second quarter, representing a 6% decrease year-over-year. Gross margin was 58.7%, and actually flat compared to the prior year quarter as favorable segment and product mix offset the unfavorable impact of foreign exchange rates and higher freight costs.

Operating expense as a percentage of sales was 35.1%, a 230 basis point increase in the prior year quarter. Operating income was $293 million, a 21% decrease. Operating margin was 23.6%, a 440 basis point decrease. Our GAAP EPS was $1.33, pro forma EPS was $1.44.

Next, look at our second quarter revenue by segment and geography. In the second quarter, double-digit growth in the outdoor and aviation segments were more than offset by declines in fitness, marine and auto segments. By geography, the Americas region was flat, contributed about half of revenue for the quarter. The EMEA and APAC regions, both impacted by foreign exchange rates, declined during the quarter.

Looking next at operating expenses. Second quarter operating expenses increased by $26 million or 6%. Research and development increased $15 million year-over-year primarily due to engineering personnel costs. SG&A increased $10 million compared to prior year quarter, primarily due to increases in personnel-related expenses, information technology costs. Our advertising expense is relatively consistent year-over-year.

The highlights on the balance sheet, cash flow statement and taxes. We ended the quarter with cash and marketable securities approximately $2.9 billion. Accounts receivable increased sequentially to $699 million, while the seasonally stronger second quarter declined year-over-year relatively in line with our sales decline. Inventory balance increased year-over-year to approximately $1.5 billion. We're executing our strategy to increase days of supply to support our increasingly diversified product lines, optimize the mix of ocean versus air freight shipments, and to carry sufficient levels of raw materials safety stock to mitigate increased lead times.

During the second quarter of 2022, we generated free cash flow of $5 million, a $115 million decrease from prior quarter primarily due to lower operating income and increased operating capital needs. Capital expenditures for the second quarter were $75 million. We expect full year 2022 free cash flow to be approximately $500 million, capital expenditures of approximately $300 million. Also in the quarter, we paid dividends of $129 million, repurchased $31 million of company shares, leaving $260 million remaining share repurchase program authorized through December 2023.

For the second quarter of 2022, the effective tax rate was 7.6% compared to 14.8% in the prior year quarter. The decrease in effective tax rate was primarily due to income mix by tax jurisdiction, an increase in U.S. tax deductions and credits.

Turning next to our full year guidance. We estimate revenue of approximately $5 billion compared to our previous guidance of $5.5 billion. As previously mentioned, strengthening of the U.S. dollar is a significant unfavorable impact on our second quarter revenue. Assuming the euro will be at parity with the U.S. dollar for the remainder of the year, year-over-year unfavorable revenue impact will accelerate in the back half of 2022. We expect gross margin to be approximately 56.7%, which is lower than our previous guidance, 57.5%, primarily due to the anticipated full year unfavorable impact of foreign exchange rates.

We expect operating margin of approximately 20%. Also, we expect a pro forma effective tax rate of 8.5%, which was lower than our previous guidance of 10.5% to projected full year income mix by tax jurisdiction. This results in expected pro forma earnings per share approximately $4.90.

This concludes our formal remarks.

Operator: Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.