Garmin Ltd.(Q4 2022 Earnings)

February 22, 2023

Corporate Speakers:

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

PRESENTATION

Operator^ Good morning, and thank you for standing by. Welcome to the Garmin Ltd. Fourth Quarter 2022 Conference Call. (Operator Instructions) Please be advised that today's conference call is being recorded. I would now like to hand the conference call over to your speaker today, Teri Seck. Please go ahead.

Teri Seck^ Good morning. We would like to welcome you to Garmin Ltd. Fourth Quarter and Fiscal Year-end 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, segment growth rates, 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 fourth quarter revenue came in at $1.3 billion, which is down 6% from the prior year and consistent with trends we experienced for most of 2022.

There are several factors that influenced our results, including the year-over-year strengthening of the U.S. dollar, macroeconomic and geopolitical concerns affecting Europe, and the performance of retailers who focused on inventory control.

One bright spot is the performance of our direct sales channel, including garmin.com, which increased by strong double digits and accounted for greater than 10% of total net sales. While our priority is to serve the needs of third-party retail partners, our direct channels are an increasingly important pillar of our go-to-market strategy.

Another bright spot is our gross margin performance, which improved 150 basis points over the prior year and exceeded expectations as we benefited from lower freight costs. Our performance in 2022 was solid despite facing a mix of persistent and emerging headwinds affecting the general business environment and consumer behaviors. We reported revenue of $4.86 billion, a 2% decline year-over-year.

Revenue was negatively impacted by approximately $228 million due to the strengthening of the U.S. dollar relative to other currencies. Excluding this impact, revenue would have increased about 2% over the prior year. Our gross margin performance was strong at 57.7% for the year, and operating margin exceeded 21%.

As announced earlier this morning, we've combined the product categories of the consumer auto segment with outdoor. I'll provide more context in a moment, but factors considered include the current size and scope of the Consumer Auto segment as well as the expected growth of the Auto OEM segment.

We're cautiously optimistic as we turn our attention to 2023. We have a great lineup of new products and additional product launches are planned throughout the year. We anticipate consolidated revenue will increase approximately 3% to $5 billion for the year. In the first quarter, we expect that revenue will decline in line with recent trends as we compare against the strong product launches from the prior year.

We expect to return to growth starting in the second quarter as we benefit from planned new product introductions. It's important to remember that we are not focused on quarter-by-quarter or category-by-category performance. Rather, we're focused on delivering solid results year after year by creating highly differentiated products and leveraging our diversified business model.

We're proposing a dividend of $2.92, consistent with the prior year, which will be considered by shareholders at the upcoming Annual General Meeting. Doug will discuss financial results in greater detail in a few minutes, but first, I'll provide highlights on the performance and outlook for each business segment.

Starting with Fitness, revenue decreased 28% for the year with declines across all categories. Full year growth in operating margins were 50% and 9%, respectively, resulting in operating income of $105 million. During the quarter, we launched our first LTE-connected kids smartwatch available exclusively at garmin.com.

(Inaudible) text and voice messaging as well as real-time location tracking. also tracks activities and steps throughout the day, offers games and allows parents to sign chores and give rewards. We continue to explore new verticals in health and wellness and recently received U.S. FDA approval for a clinically validated ECG app for the Venu 2S smartwatch. This app allows users to record their heart rhythms and checks for signs of AFib.

We believe this is an important step towards providing a full line of devices for managing a variety of health conditions. For 2023, we expect revenue to be down approximately 5% in the segment as it stabilizes and as we anticipate the benefit of new product introductions.

Moving to Outdoor. Full year revenue increased 17% resulting in record revenue of nearly $1.5 billion for the year. We experienced growth across multiple product categories, led by strong demand for adventure watches. Full year growth and operating margins were 65% and 37%, respectively, resulting in operating income of $556 million.

During the quarter, we launched the second-generation MARQ luxury smartwatch featuring a bright AMOLED touchscreen display and premium Grade 5 titanium materials. We also expanded the Instinct product line with the new crossover, a unique hybrid smartwatch that is fully analog and fully digital.

Looking ahead, we expect the Outdoor segment to grow approximately 2%, which includes contributions from Consumer Auto. We expect the first quarter of 2023 to be challenging as we compare against the strong results from the prior year, which were driven by the launch of the flagship Phoenix 7 Series, the Instinct 2 series and the all new Epix.

We expect growth to resume starting in the second quarter, driven once again by new product introductions. Looking next at Aviation, full year revenue increased 11%, with contributions from both aftermarket and OEM categories and as supply chain constraints eased. 2022 was a record year for our Aviation segment with revenue approaching $800 million and exceeding the levels achieved during the ADS-B mandate, which demonstrates our ability to deliver long-term growth in core product categories, such as autopilots, GPS NAV COM, display systems and services.

Full year growth and operating margins were 72% and 27%, respectively, resulting in operating income of $213 million. During the quarter, we announced that L3 Harris Technologies has chosen the G3000 tandem integrated flight deck as part of the U.S. Special Operations Command Armed Overwatch Program.

The G3000 system will provide the latest communication, navigation, surveillance and air traffic management capabilities for the Sky Warden aircraft. Also, we received EASA approval for the G5000 retrofit integrated flight tech in the Citation XL and the XLS. We also received FAA supplemental type certificate for the GI275 electronic flight instrument in the Dassault Falcon 7X business jet.

These approvals expand the addressable market for integrated flight decks and standby instrumentation in business jets. The Aviation segment continues to benefit from strong demand for both aftermarket products and new aircraft equipped with integrated cockpit systems. We expect these trends to drive revenue growth of approximately 5% for the year.

Turning to Marine. The segment delivered its tenth consecutive year of revenue growth, starting from about $200 million in 2012 and exceeding in $900 million in 2022, which is a new record and represents a compounded annual growth rate of 15%, driven by both market growth and significant market share gains. For 2022, revenue increased 3%, with growth across multiple categories, led by strong demand for sonar systems.

Full year growth and operating margins were 54% and 24%, respectively, resulting in operating income of $215 million. During the quarter, we announced that Garmin Navionics Plus is now preloaded in certain flagship GPS map chartplotters, combining the best-in-class charts from both Navionics and Garmin.

Throughout the year, we received multiple accolades and awards, most recently the prestigious IBEX Innovation Award, The National Boating Industry Safety Award and recognition as one of the most innovative marine companies by Soundings Trade Only.

Looking forward, we anticipate revenue from the Marine segment will increase approximately 5% for the year, as we leverage our strong market share position with typical marine growth patterns.

Moving to the Auto segment. Full year revenue decreased 4% as growth in auto OEM was more than offset by declines in Consumer Auto categories. As mentioned earlier, we recently combined the product categories of Consumer Auto with Outdoor. As many know, we were an early innovator in the consumer automotive market and the hyper growth we experienced in the mid-2000s allowed us to invest in new opportunities and become the strong, highly diversified company that we are today.

Looking back in 2008, revenue from the Automobile segment exceeded $2.5 billion and represented more than 70% of our consolidated revenue. Since that time, we've diversified our revenue base and the Consumer Auto segment has evolved into a collection of important specialty categories, many of which target adventure and off-road vehicles that complement the strategic focus of the Outdoor segment.

Separately, we believe that the Auto OEM segment has reached a critical inflection point as new programs move into production, driving significant growth over the next few years. We will report auto OEM as a stand-alone segment starting with fiscal year 2023.

This change in segment organization provides an opportunity to discuss why we have chosen to participate in the auto OEM market. The automotive market is undergoing significant transformation as electrification gains momentum. While the industry has many capable suppliers, not all are equipped to meet the demand as the electronic and software content in vehicles rapidly evolves.

Our vision is to be recognized as a leading global supplier of integrated electronic solutions to the auto industry. To achieve this vision, we intend to leverage our technology portfolio, our vertically integrated business model and our global manufacturing footprint.

Auto OEM revenue is generated from 3 product categories: domain controllers, infotainment units and all other. Explaining a little bit about these categories, domain controllers are remote computing modules that control various systems throughout the vehicle. The BMW program consists primarily of domain controllers for infotainment, instrumentation and rear seat entertainment.

Infotainment units are self-contained systems that include a display and the user control system for functions such as navigation, audio, multimedia and Internet-based apps. We currently supply infotainment units to automakers in Asia and Europe.

And finally, the Other category includes a collection of software, map database, cameras, wearables and other revenue lines. Our current customer base includes some of the most respected global automakers including BMW, Toyota, Yamaha, Honda, Daimler, Ford and Geely. We are working with these and many other OEMs on future opportunities.

During 2022, Auto OEM revenue increased 11%, $284 million, with growth driven by contributions from new programs. Full year gross margin was 32%, and we recorded an operating loss of $79 million, driven by ongoing investments to complete new programs. This operating loss was $29 million lower than the prior year and was better than expectations due to higher sales and a reduction in development expenses.

Late last year, the BMW Group recognized Garmin with a Supplier Innovation Award for our work on the theater screen rear seat entertainment system offered on the flagship 7 Series automobile. This is a significant achievement considering the complexity of the program, the high expectations of our customer and the fact that we're a relative newcomer to the industry.

I'm also pleased to report that during 2022, we secured additional commitments from BMW that increased our total awarded volume by nearly 50% and expanded our supply footprint, which now encompasses the North American region, Europe and China.

Looking forward, we expect Auto OEM revenue to increase 30% in 2023. We expect the first quarter to be approximately flat to the prior year with significant growth starting in Q2, driven by the timing of new model launches.

Many are wondering about our long-term outlook for the Auto OEM segment and importantly, the pathway to profitability. While we do not provide guidance beyond the current year, we can share our vision for where the Auto OEM segment goes from here. Our long-term projections consider programs currently awarded along with many other assumptions that may or may not materialize.

Based only on the business already secured, our projections indicate that we could experience a compound annual growth rate of approximately 40% over the next few years, which, if achieved, would result in 2025 revenue of approximately $800 million. We anticipate much of this growth will be driven by domain controllers that carry a lower gross margin profile, but also generate significant volume leverage as we aim for profitability in 2024.

We plan to build on this success with innovation that leads to new opportunities such as the highly acclaimed unified cabin concept we showcased at the recent Consumer Electronics Show.

In summary, 2023 marks the beginning of a new era for our Auto OEM segment. The opportunity is significant, the path forward is clear and we're focused on delivering growth and profits in the Auto OEM segment. That concludes my remarks. Next, Doug will walk you through additional details on our financial results and our 2023 guidance. Doug?

Douglas Boessen^ Thanks, Cliff. Good morning, everyone. I'll begin by reviewing our fourth quarter and full year financial results and provide comments on the balance sheet, cash flow statement, taxes and 2023 guidance revenue of over $1.3 billion for the fourth quarter, representing a 6% decrease year-over-year. Gross margin was 57%, a 150 basis point increase from the prior quarter. Increase was primarily due to lower freight costs. Operating expense as a percentage of sales was 36.5%, a 370 basis point increase.

Operating income was $267 million, 15% year-over-year decrease. Operating margin was 20.5%, 210 basis point decrease from the prior year. Our GAAP EPS was $1.53, and our pro forma EPS was $1.35, a 13% decrease from the prior year pro forma EPS.

Looking at the full year results, we posted revenue of $4.860 billion representing a 2% decrease year-over-year. Gross margin was 57.7%, 30 basis point decrease in the prior year. Operating expense as a percentage of sales was 36.6%, 300 basis point increase.

Operating income was [$1.028] billion, a 16% decrease. Operating margin was 21.1%, 340 basis point decrease from the prior year. Our GAAP EPS was $5.04, pro forma EPS was $5.13, 12% decrease from the prior year pro forma EPS.

Next, our fourth quarter revenue by segment and geography. In the fourth quarter, growth in the Aviation, Marine and Outdoor segments was more than offset by declines in the Fitness and Auto segments, resulting in 6% consolidated decline.

By geography, the 4% growth in Americas was more than offset by 17% decline in EMEA, a 9% decline in APAC, which was negatively impacted by foreign exchange rates during the quarter. For the full year 2022, consolidated revenue declined 2% with growth in the Outdoor, Aviation and Marine segments more than offset declines in the Fitness and Auto segments.

By geography, we achieved 3% growth both Americas and APAC, but these increases were more than offset by a 12% decline in EMEA.

Looking next operating expenses. Fourth quarter operating expenses increased by $21 million or 5%. Research and development increased approximately $11 million year-over-year, primarily due to engineering personnel costs. SG&A increased approximately $13 million compared to prior year quarter, primarily due to increases in personnel-related expenses, formation, technology costs.

Advertising expense decreased approximately $3 million due to lower co-op advertising. Few highlights on the balance sheet, cash flow statement, dividends and share repurchase. We ended the quarter with cash, marketable securities, approximately $2.7 billion.

Accounts receivable increased sequentially to $657 million to seasonally strong sales in the fourth quarter and decreased year-over-year. Inventory increased year-over-year to approximately $1.5 billion, year-over-year increase due to executing our strategy to reduce freight costs through higher mix ocean versus air shipments as well as implications of navigating a challenging supply chain environment, which we've been operating.

As the business environment continues to evolve, we're working to optimize our inventory. As such, we anticipate our 2023 ending inventory balance to be relatively flat year-over-year. The expected declines in our consumer inventory offset by expected increases associated with the growth of our Auto OEM business.

During the fourth quarter of 2022, we generated free cash flow of $309 million, $260 million increase from the prior year quarter. For the full year 2022, we generated free cash flow of approximately $544 million, a $161 million decrease from the prior year, which was primarily due to a higher use of cash for inventory income taxes.

For 2023, we expect free cash flow to be approximately $700 million, approximately $275 million of capital expenditures. For 2023, we expect to continue to make investments in platforms for growth including continued renovation of our facilities in Taiwan and IT-related projects.

As a result of the additional week in the fourth quarter 2022, we paid 2 quarterly dividends totaling approximately $280 million. Also, we announced our plan to seek shareholder approval for an annual dividend of $2.92 or $0.73 per share per quarter with our June 2023 payment.

2022, we purchased $207 million of company stock, had approximately $93 million remaining as of year-end, the share repurchase program, which is authorized through December 2023. For full year 2022, we reported an effective tax rate of 8.6%. Pro forma effective tax rate was 7.9%, a 240 basis point decrease from the prior year, primarily due to favorable income mix by tax jurisdiction, increase in U.S. tax deductions and credits.

Fiscal year 2023 pro forma effective tax rate is expected to be 8% flat year-over-year. Turning next to our full year guidance. We estimate revenue of approximately $5 billion, an increase of approximately 3% for the prior year.

We expect gross margin to be approximately 57.5%, which is relatively consistent to our full year 2022 gross margin. We expect an operating margin of approximately 20.3%. In the full year, pro forma effective tax rate expected to be approximately 8% results in expected pro forma earnings per share of approximately $5.15. This concludes our formal remarks.

Teri Seck^ Thank you, everyone. As always, Doug and I are available for callbacks throughout the day, and we hope you have a wonderful day. Bye.

Operator^ Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.