MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Garmin Limited First Quarter 2013 Earnings Conference Call. Today's call is being recorded. At this time, I'd like to turn the call over to Ms. Kerri Thurston. Please go ahead.

Kerri R. Thurston, Director-Investor Relations

Thank you and good morning, everyone. We'd like to welcome you to Garmin Limited's First Quarter 2013 Earnings Call. Please note that the earnings press release and related slides are available at Garmin's Investor Relations site on the Internet. An archive of the webcast and related transcript will also be available on our website later today and will posted through the end of May.

This earnings call includes projections and other forward-looking statements regarding Garmin Limited and its businesses. Any statements regarding our future financial position, revenues, earnings, market share, product introductions, future demand for our products 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 for the year ended December 29, 2012, filed with the SEC.

Presenting on behalf of Garmin Limited this morning are Cliff Pemble, President and CEO, and Kevin Rauckman, Chief Financial Officer and Treasurer.

At this time, I'll turn the call over to Cliff.

Clifton A. Pemble, President and Chief Operating Officer

Thank you, Kerri, and good morning, everyone. As we announced earlier this morning, Garmin generated solid margin performance with revenue growth concentrated in highly profitable segments. While consolidated revenues decreased 4% year-over-year, two of our most profitable segments, Aviation and Fitness, posted revenue growth. In total, our traditional market segments of Outdoor, Fitness, Marine and Aviation contributed 52% of the total revenue mix in the quarter.

Gross margins improved to 52% from 51% in the prior year. We experienced margin improvement due to the amortization of previously deferred high margin revenue and the shifting of revenues towards high gross margin segments. Operating margins were 15%, a slight decline from 16% in the prior year, with traditional markets providing 75% of the operating income in the quarter. Kevin will further discuss our financial results in a few minutes. We sold 2.5 million units in the quarter, down 8% year-over-year. Declining PND volumes were partially offset by growth in Fitness, Aviation and Outdoor.

Next I'll walk you through a review of our results segment by segment. Revenue in the Marine segment declined 10%, driven by several factors, including an aging product lineup, unfavorable weather conditions and ongoing economic uncertainty. Unfortunately, we also recorded an operating loss in the quarter, as gross margin was pressured by discounting of existing products. At the same time, R&D expenses were higher creating further profitability headwinds.

While the first quarter marks two consecutive quarters of operating loss in Marine, we are committed to returning the segment to long-term profitability through improved efficiency and with the contribution of new products. One of the most important new products is the GPSMAP 8000 series which will ship this month. This series of glass helm products offer unparalleled features in design while also providing the ease of use that customers expect from Garmin.

In Aviation, we posted revenue growth of 10% with the OEM market contributing to strong gains in the quarter. In particular, we saw growth from new customers and recent certifications, an expanding presence in helicopters and the emergence of Hawker Beechcraft from bankruptcy. Revenue growth along with strong margin performance in the segment translated to 22% operating income growth for Aviation.

During the quarter, we continued to gain market share in the helicopter industry with Enstrom announcing their selection of our G1000H for their 480B helicopter. Also in the quarter, we expanded our leadership in ADS-B solutions with the delivery of certified products that meet the requirements of the FAA mandate for tens of thousands of impacted and eligible aircraft.

While our first quarter performance was strong, we recognize that demand for light business jets remains under pressure and thus, we are cautious. We continue to look towards the future by investing in multiple business jet certifications slated for entry into service later in 2013 and beyond. In addition, we've introduced innovative new products for the experimental aircraft market and mobile applications that solidify Garmin's leadership in a broad range of solutions for general aviation.

Outdoor segment revenues declined slightly in the seasonally weak first quarter. We also experienced some gross margin compression as pricing declined slightly and product mix skewed towards low-end devices. Given that the first quarter is traditionally the weakest for the segment, we expect margins to improve for the remainder of the year. As we look at 2013, we continue to see significant opportunities for growth through new products that will be shipping throughout the year, ongoing market share gains in key categories like golf, dog tracking and training, and ongoing expansion into new adjacent markets.

Turning next to the Fitness segment, revenue grew 2% on a year-over-year basis as our new cycling products performed well in the marketplace. While this growth may appear less robust than expected, it is important to remember that the Fitness segment experienced 26% growth in the first quarter of 2012 with the launch of the Forerunner 910XT, resulting in a challenging year-over-year comparison.

During the quarter, we made significant enhancements to Garmin Connect with improved social features and training plan capabilities that enhanced the utility and appeal of our online fitness portal.

As we reflect on the fitness market, we remain excited about the opportunity as active lifestyles continue to gain popularity. To illustrate, Running USA estimates that participation in half marathon events in the U.S. increased by 15% in 2012, and the trend is expected to continue in the future. USA Triathlon reported a 20% increase in memberships in 2012, with a 10% increase in adult memberships, and over 40% increase in youth memberships.

These trends support our belief that the fitness market will continue to grow for many years to come. Finally, we anticipate entering new adjacent markets in the future. In particular, we are pleased with the progress our Vector power meter is making, which remains on track for delivery this summer.

Finally in Auto/Mobile, revenues were down 10% with PND volumes declining as anticipated partially offset by the amortization of previously deferred revenues and growth in our OEM product categories. Given that we entered 2013 expecting PND market declines, we are managing the business to this reality in order to ensure long-term profitability for the segment.

Overall, our expectations for the PND category remain unchanged with annual volumes down approximately 20% on a global basis. Our R&D efforts in the segment are focused on essential features that enhance the driving experience, and building upon our success in the OEM market by providing superior integration of technologies with an intuitive user interface.

One recent success to highlight is our announcement of the partnership with Mercedes-Benz. We will provide Garmin branded navigation solutions beginning in some 2014 models with expansion into additional models over the next four years. This software-based solution provides seamless integration with the infotainment system using the award-winning Garmin user interface.

Our software system provides navigation information to the instrument cluster directly in front of the driver, which is known to reduce driver workload and distraction. Our system also includes the underlying engine providing location data for the advanced driver assistance functions that Mercedes-Benz will be offering in future models. This is an exciting partnership and highlights the success that our OEM team has achieved in gaining new business opportunities across the automotive brand spectrum.

That concludes my formal remarks. Kevin will now provide a more detailed review of our financial performance for the quarter. Kevin?

Kevin S. Rauckman, Chief Financial Officer

Thanks, Cliff. Good morning, everyone. I'd like to begin by reviewing our income statement and segment results, then move to summary comments on the balance sheet, cash flow, taxes and guidance for the year.

We posted revenue of $532 million for the quarter with net income of $89 million. Our pro forma EPS was $0.40 per share excluding the foreign currency loss and tax benefits due to the release of reserves. Our revenue represents a decrease of 4% year-over-year. Gross margin came in at 52%, a 90-basis point improvement from prior year, driven by the benefit of deferred revenue amortization.

Operating margin was 15%, down 120 basis points from the prior year. The components were the gross margin favorability of 90 bps, offset by an unfavorable operating expense impact of 210 basis points. Total operating expenses increased by $3 million in the current quarter, driven by an $8 million increase in research and development. Each of the operating expense categories will be discussed further on a later slide.

Our pro forma EPS, which is adjusted for both foreign currency losses and tax benefits from the release of reserves, was $0.40, representing an 11% decrease year-over-year. We shipped 2.5 million units during the quarter, which represents an 8% decrease year-over-year. Total company average selling price was $214 per unit, up from $205 in Q1 2012, driven primarily by the amortization of previously deferred revenue.

Cliff has summarized the revenue change by segment, but I would just like to briefly highlight the charts on this page, which illustrate the Auto/Mobile segment representing less than 50% of our total revenue during Q1 2013, as both Aviation and Fitness grew in the quarter.

Looking at profitability by segment, we have almost equal operating income contribution from each of our profitable segments in Q1 2013 with an offsetting loss in Marine. Due to the improved operating margin of Auto/Mobile in the current year, the operating income contribution of this segment increased to 25% from 20% in 2012. Aviation also contributed an increasing proportion of the operating profit in the current year due to revenue growth and improved margins. The Aviation segment contributed 26% in the current quarter compared to 19% in the prior year.

I'd like to briefly discuss year-over-year margin changes. Gross margins improved by 90 basis points in the quarter as Auto/Mobile and Aviation margins improved. The Auto/Mobile improvement is attributable to the increased amortization of previously deferred high margin revenue. Aviation gross margin improvement is primarily due to improving volumes and sales mix. Offsetting this improvement was a significant decline in Marine gross margin, as Cliff previously discussed.

Operating margin declined 120 basis points due to increased R&D spending in every segment. Marine was the most impacted with a 24% increase in R&D leading to an operating loss in the quarter. In Outdoor, operating margins also declined attributable to gross margin pressure caused by product mix and pricing, a 17% increase in R&D and a slight increase in SG&A based on expense allocations.

As previously mentioned, in Q1, operating expenses increased by $3 million on a year-over-year basis, from $193 million in Q1 2012 to $196 million in Q1 of 2013, an increase of 210 basis points as a percentage of sales. R&D was the only expense category that increased, with an $8 million year-over-year impact. This represented a 220-basis point impact as a percent of sales to 16% of sales. We continue to invest in innovation and grow our engineering work force.

Our advertising spending decreased $2 million over the year-ago quarter and decreased 10 basis points as a percent of sales at 4% in Q1 2013. We will continue to scale our advertising expense to match our revenue trends.

SG&A decreased $4 million compared to the year-ago quarter and remained steady at 16% of sales. The decrease is primarily attributable to legal fees.

Instead of showing an eye chart with full balance sheet and cash flow statement, we just wanted to highlight a few items allowing you to reference the full statements in our press release. We ended the quarter with cash and marketable securities of over $2.7 billion. This is a decline from the end of 2012, as we paid both the December 31 and March 31 dividend in the quarter.

Accounts receivables decreased sequentially to $451 million due to the seasonality of the first quarter. Accounts receivables accounted for 64 days of sales compared to 81 days of sales in the fourth quarter and 56 days of sales in the first quarter of 2012.

Our inventory balance increased slightly to $396 million on a sequential basis at the close of first quarter in preparation for the stronger seasonal period. Our days of inventory were 119 days compared to 117 in the fourth quarter of 2012 and 102 days in the first quarter of 2012.

We do not currently show a dividend payable, as this $1.80 per share proposed by the Board requires approval of our shareholders on June 7 at the annual meeting.

We continue to generate free cash flow across our business, as cash from operations was $59 million during the first quarter. This was negatively impacted by a $41 million tax-related prepayment that will be reimbursed in the second quarter. Our CapEx during Q1 was $12 million. Therefore, we generated free cash during the quarter of $48 million. This would've been $90 million without the tax prepayment.

Financing activities were a $174 million use of cash during Q1 due primarily to the dividend payments on December 31 and March 31. We expect our second quarter will show a significant lift in free cash generation.

A few more items to highlight during our Q1 results. Our recorded tax rate for Q1 was negative 8.6%. The favorability resulted from reserve releases associated with completed audits and an expiration of statutes in certain jurisdictions. Without this benefit, our tax rate would have been 11.6%. Also in the quarter, we recognized 2012 R&D tax credits due to the delayed enactment of applicable tax legislation. As we indicated in February, this credit was factored into our overall tax rate forecast for the year.

We did not repurchase any shares in the first quarter, but we do intend to repurchase shares throughout the year. Finally, at this time, we are maintaining our full year guidance of $2.5 billion to $2.6 billion in revenue and $2.30 to $2.40 of pro forma EPS. As in prior years, we will update 2013 guidance by segment after the second quarter, which is a seasonally stronger quarter, providing a better preview for the back half of the year.

This concludes our formal remarks.