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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Garmin First Quarter 2014 Earnings Conference Call. Today's call is being recorded. At this time, I'd like to turn the call over to Kerri Thurston. Please go ahead.

Kerri R. Thurston, Director-Investor Relations

Thank you. Good morning, everyone. We'd like to welcome you to Garmin Limited's first quarter 2014 earnings call. Please note that the earnings press release and the related slides are available at Garmin's Investor Relations site on the Internet at www.garmin.com/stock. An archive of the webcast and a related transcript will also be available on our website later today.

This earnings call includes projections and other forward-looking statements regarding Garmin Limited and its business. 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, filed with the SEC.

Presenting on behalf of Garmin Limited this morning are Cliff Pemble, President and CEO; and Kevin Rauckman, CFO and Treasurer.

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

Clifton A. Pemble, President and Chief Executive Officer

Thank you, Kerri, and good morning, everyone. As announced earlier this morning Garmin reported strong first quarter revenue and margin performance with revenue operating income and pro forma EPS growth. Consolidated revenues increased 10% year-over-year with revenue from aviation, fitness marine and outdoor growing 22% on a combined basis. These segments contributed 58% of the total revenue and 75% of the operating profit in the first quarter.

Gross margins improved year-over-year to 57% from 52% in 2013 due to the amortization of previously deferred revenue and improved segment mix. Operating margins were 21%, an increase from 15% in the prior year. This resulted in operating income growth of 51% on a consolidated basis with each segment contributing.

These strong results allowed us to generate $0.55 of pro forma EPS in the quarter, an increase of 38% over 2013. Kevin will discuss our financial results in greater detail in a few minutes. First, I'll walk through a review of our results segment by segment.

Beginning with the fitness segment, revenue grew 38% on a year-over-year basis, as our new running products performed well and we began shipping our vívofit activity tracker. We delivered gross and operating margins of 64% and 33% respectively. Operating income grew 68% in the quarter as the operating margin expanded by almost 600 basis points due to higher sales.

The launch of the vívofit in the first quarter has gone well and we expect it to be a driver of growth for the remainder of the year as the wellness market rapidly expands. In cycling, we announced the Edge 1000, a high-end solution that sets a new standard for cycling computers. The Edge 1000 features a large sunlight-readable color display, capacitive touch, competitive segment capabilities and smartphone connectivity.

Finally, while we are currently experiencing a period of strong growth fueled by new products, we see additional opportunities we can capture in both the short-term and long-term. With this outlook in mind, we've increased our R&D investment in fitness to support future innovation and a robust pipeline of new products and services that are yet to come.

In aviation, we posted revenue growth of 19%, with both OEM and aftermarket product categories contributing to the growth.

Operating income grew 38% in the quarter ahead of revenue growth due to the improvement in both gross and operating margins. While these are strong results, we continue to face a challenging market as new aircraft sales remain below historical levels. Throughout the quarter, we extended our aftermarket product portfolio to include portable weather receivers, angle of attack technology and additional radar altimeter solutions. These additions have allowed us to expand the addressable market for Garmin in the aftermarket space.

Another introduction in the quarter was the G3X Touch designed for the Light Sport aircraft market. The G3X has already achieved strong acceptance at Light Sport OEMs with five partners offering the product on 13 different models. Finally, we also expanded our relationship with Cessna to include the CJ 3+ and the Alpine Edition CJ 2+, which will now offer Garmin's G3000 cockpit system.

Revenue in the marine segment grew 19% in the quarter due to the introduction of new products and weak comparables in the first quarter of 2013. Profitability improved in the first quarter, however, the pricing environment remains competitive resulting in margins below historical levels. I am pleased to report that we delivered our new products for 2014 ahead of the buying season and anticipate gaining market share with these strong offerings.

While industry activity is far below historical levels, we remain committed to innovation that will lead to long-term improvements in market share and profitability.

Looking at outdoor, revenues grew 10% with each major product category contributing, growth and operating margins remain strong in the segment at 61% and 28% respectively.

During the quarter, we introduced the fenix 2 and the PRO Series of dog training collars. The fenix 2 builds on the capabilities of the original fenix by adding advanced fitness training features and smartphone connectivity. The PRO Series of dog training collars expands our offerings for the sports dog category with the integration of proven Tri-Tronics technology and new features for the dog trainer.

Finally in Outdoor, we wanted to provide an update on our progress in the action camera market. To date, market share gains have developed more slowly than planned due to the relative maturity of the market and the existence of strong well-entrenched competitors. However, we entered this market because we believe we have unique innovations to offer customers pursuing active lifestyles. With this in mind, we are increasing promotional activities to support our current offerings and we are also stepping up our R&D investment to develop the next generation of action cameras.

In our auto/mobile segment, revenues were down 4% in the quarter, with PND unit volumes declining at a global rate of almost 20% which is in line with our expectations. This decline was partially offset by growth in OEM as well as the amortization of previously deferred revenues.

The segment remains highly profitable with gross and operating margins of 47% and 13% respectively and we continue to experience gains in global market share. As indicated in our February guidance, we expect the 2014 PND market to decline approximately 20% on a global

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basis. This will be partially offset by growth opportunities in OEM, RVs, Dash cameras and other specialty automotive products.

As a final note for this segment, the Garmin-equipped Mercedes C class is now shipping. The selection of Garmin navigation in Mercedes vehicles is a strong vote of confidence in our offerings and capabilities as an OEM supplier. We plan to build on this momentum, as we pursue additional opportunities for our OEM software and hardware solutions.

Finally, while results in the first quarter exceeded our expectations, it is also the weakest quarter with a large portion of the year still ahead. With this in mind, we will update guidance after the second quarter according to our typical practice when we anticipate having improved visibility on the PND market trends and our progress in new product categories.

I'd like to touch briefly on the CFO transition. As you will recall in February, Kevin announced his plan to leave the CFO role by the end of this year. Speaking generally, I feel good about our progress so far, and I am confident in our ability to effect a smooth transition, as we've planned since the beginning.

That concludes my remarks, Kevin will now walk through our Q1 financial results in more detail. Kevin?

Kevin S. Rauckman, Chief Financial Officer & Treasurer

Thank you, Cliff, and good morning, everyone. I'd like to begin by reviewing our financial results and then move to summary comments on both the balance sheet and the cash flow.

So we posted revenue of $583 million for the quarter with pro forma net income of $108 million. Our pro forma EPS was $0.55 per share excluding the FX gain during the quarter. Our revenue represents an increase of 10% year-over-year as previously highlighted by Cliff.

Gross margin was strong at 57%, a 480 basis point increase from prior year, driven by a segment mix with improved margins in each segment and the amortization of previously deferred revenues.

Operating margin was 21%, an increase of 560 basis points from the prior year. This is the result of the gross margin favorability at 480 basis points as well as the operating expense favorability of 80 basis points. Total operating expenses did increase by $14 million or 7%. Each of the operating expense categories will be discussed in detail on a later slide. Our effective tax rate increased to 16.6% in the quarter with the prior year rate positively impacted by $6.3 million benefit from the retroactive reinstatement of the federal R&D tax credit, which again expired at the end of December 2013.

Our pro forma EPS, which is adjusted for the foreign currency gains, was $0.55 representing a 38% increase year-over-year. And we shipped $2.5 million units during the quarter basically flat from our 2013 results. Total company average selling price was $234 per unit, up 10% from 2013 in Q1 2013 driven primarily by the segment mix and reduced revenue deferrals.

Next, you can see how our first quarter revenue breaks down by segment. I'd just like to briefly highlight the charts on this page, which illustrate the auto/mobile segment representing 42% of our total revenue during Q1 of 2014, as each of the non-auto/mobile segments grew double digits during the quarter.

You can see from the profitability mix by segment that our non-auto/mobile segments delivered 75% of operating income in the quarter equivalent to Q1 2013 due to the margin improvement in auto/mobile.

I'd like to briefly discuss year-over-year gross margin changes by segments. Auto/mobile gross margin increased to 47% from 42% in the prior year, due primarily to the amortization of high-margin deferred revenues. In addition, we posted gross margin improvement in each of the non-auto/mobile segments. This margin improvement was primarily related to product mix shifting toward new products in marine, outdoor and fitness. In addition, ASP improvement also contributed in marine and outdoor and aviation margin improvement was primarily due to increased software sales. Total corporate operating margin improved to 21% due to the increase in gross margin and revenue growth outpacing the 7% growth of operating expenses which I will highlight next.

Our Q1 operating expenses increased by $14 million or 7% on a year-over-year basis in Q1, while decreasing 80 basis points as a percentage of sales, as revenue growth outpaced expense growth. R&D increased $8 million year-over-year while remaining consistent year-over-year at 16.5% sales. We continue to invest in innovation and grow our engineering workforce with focus on aviation, outdoor and fitness segment.

Our advertising spending increased $2 million over the year ago quarter while being consistent as a percentage of sales. The additional spending was focused in outdoor and marine to support new products and categories. We will continue to manage advertising expenses by segment to match the market opportunities presented by our diverse products.

And SG&A was up $4 million compared to the year ago quarter decreasing 80 basis points as a percentage of sales. We'll continue to manage these expense, these costs to align with the changing dynamics of our business.

Finally, we ended the quarter with cash and marketable securities of over $2.8 billion. Accounts receivable decreased sequentially to $427 million following the holiday quarter.

Our inventory balance increased to $442 million on a sequential basis as we built inventory levels to support the launch of new product categories and in preparation for the seasonally stronger second quarter.

We continue to generate strong free cash flow, across our business, as cash from operations was $71 million during Q1 and CapEx was $15 million. Therefore, we generated free cash of $56 million in the quarter. And we also repurchased $33 million of company stock and now have $208 million still authorized to repurchase through December of 2014.