MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Garmin Second 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

Good morning, everyone. We'd like to welcome you to Garmin Limited's second quarter 2013 earnings call. Please note that the earnings press release and the 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 until August 30.

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 for the year ended December 29, 2012, filed with the Securities and Exchange Commission.

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

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

Clifton A. Pemble, President and Chief Executive Officer

Thank you, Kerri, and good morning, everyone. As we announced earlier this morning, Garmin recorded strong second quarter revenue and margin performance with revenue growth in each of our traditional segments of outdoor, fitness, marine and aviation. While consolidated revenues decreased 3% year-over-year, our traditional market segments contributed 50% of the total revenue mix in the quarter and grew 8% on a combined basis.

Gross margins improved sequentially to 55% from 52% in the prior quarter, as segment mix and product mix improved in the seasonally stronger second quarter. Gross margins declined from 59% in the prior year when margins were aided by a one-time royalty benefit of $21 million.

Operating margins were 24%, a sequential improvement from 15% in the first quarter, but a decline from 28% in the prior year due to the royalty benefit. Traditional markets contributed 64% of the operating income in the quarter. These strong results allowed us to generate $186 million of free cash flow in the quarter. Kevin will further discuss our financial results in a few minutes.

Next, I'll walk you through a review of our results segment by segment. Starting first with the outdoor segment, revenues grew 6% in the quarter, generating 3% operating income growth. Our newer product categories continue to perform well, with golf products and dog tracking and training solutions contributing to the growth. As we forecasted in the first quarter, margins improved as we entered a more seasonally robust period.

As we look at the back half of 2013, we continue to see significant opportunities for growth with the introduction of new products and new product categories. The recently introduced Monterra is one example. Targeting a new generation of outdoor enthusiast and professionals, the Monterra is built on the android open OS architecture and offers expanded utility through the availability of third party applications from the Google Play Store. In addition, there will be ongoing expansion into new adjacent markets.

Turning next to the Fitness segment, revenue grew 3% on a year-over-year basis as our new cycling products and the Forerunner 10 performed well in the marketplace. Our level of R&D investment in Fitness continues to grow as we prepare for a number of product launches in the back half of 2013 and also explore new product categories.

The most anticipated new product deliveries in the third quarter is the Vector power meter which is expected to accelerate revenue growth in the back half of the year. Vector has entered mass production and we expect to deliver the product to retailers soon. We are thrilled to finally cross the finish line with this new product and anticipate our customers will appreciate the unique features and value proposition that Vector brings to the cycling market. Finally, as we previously stated, we anticipated entering new adjacent markets in the future and continue to make investments that position us for long-term opportunities.

In Aviation, we posted robust revenue growth of 16% with both OEM and aftermarket contributing to strong gains in the quarter. Operating income was flat, due to the acceleration of R&D spending, which increased by $8 million over the second quarter of 2012.

We are making good progress in the completion of deliverables for the G5000 system which enables our OEM partners to complete aircraft level certification work. Overall, we expect our Aviation segment to perform well for the remainder of the year as the broader market improves and as we benefit from new platforms with our OEM customers.

Revenue in the Marine segment grew 7% in the quarter as we delivered new products to the market, including our GPSMAP 8000 series glass helms and our new combination products as well.

Operating margin came in at 20%, rebounding sharply on a sequential basis as new products and higher volumes contributed to improved performance. While this is still not where we would like to be in the long-term, we believe it is a step in the right direction.

Market results indicate our new products are doing well and strong shipments have continued into the third quarter due to pent-up demand for these products and aided by the delayed start of the marine season caused by unseasonably cool temperatures.

As with each of our segments, R&D expense continues to increase driven mainly by the increase in staff over the course of the past year. In the marine segment, we believe our staffing levels are now appropriate and consequently the rate of growth should stabilize going forward.

Finally in our Auto/Mobile segment, revenues were down 12% in the quarter with PND market volumes declining at a global rate of approximately 20% as we anticipated. This decline was partially offset by ongoing market share gains, growth in our OEM business and the amortization of previously deferred revenues.

During the quarter, we launched our 7-inch nuvis which have unique differentiators over competitive and substitute solutions, such as the larger screen and lifetime digital traffic. We also announced the expansion of our relationships with Volkswagen and Mini offering factory or dealer installed solutions at compelling price points for the compact car market.

Overall, our expectations for the PND category remain unchanged with industry volumes down approximately 20% on a global basis. As we focus on profitability in the category, we will continue to identify niche opportunities such as fleet management, over-the-road trucking and our recently introduced head-up display for mobile applications.

Finally, as stated in the press release, we are maintaining our revenue and pro forma EPS guidance for 2013. While our performance was strong in the second quarter and our traditional markets are on a solid trajectory of growth, we continue to expect the declines in the PND market will be a significant headwind for our top and bottom line.

In particular, we expect PND revenues to further decelerate as we compare against the period of strong sell-in during the third quarter of 2012, driven by the timing of new products and end of life promotional activity. We anticipate operating income and operating margin will trend towards the high end of our prior range, which will be offset by an anticipated increase in our tax rate.

That concludes my remarks. Kevin will now walk us through our Q2 financials in more detail. Kevin?

Kevin S. Rauckman, Chief Financial Officer

Thanks, Cliff. Good morning, everyone. I'd like to begin by reviewing our income statement and segments results, then move to summary comments on the balance sheet, cash flow, taxes and guidance. We posted revenue of $697 million for the quarter with pro forma net income of $150 million.

Our pro forma EPS was $0.76 per share excluding the large FX gain. Our revenue represents a decrease of 3% year-over-year. Gross margin came in at 55%, a 370 basis point decline from prior year, driven primarily by the $21 million one-time royalty benefit recorded in the second quarter of 2012.

Operating margin was 24%, down 400 basis points from the prior year. The components were gross margin unfavorable by 370 basis points and an unfavorable operating expense impact of 30 basis points. Total operating expenses decreased by $4 million in the current quarter with strong reductions in advertising and SG&A, partially offset by a $16 million increase in research and development. Each of the operating expense categories will be discussed in detail on a later slide.

Our pro forma EPS which is adjusted for the foreign currency gain was $0.76, representing a 22% decrease year-over-year. And we shipped 3.6 million units during the quarter, which represents a 7% decrease year-over-year. Total company average selling price was $192 per unit, up from $184 in Q2 2012, driven primarily by segment mix and the amortization of previously deferred revenue.

Cliff has summarized revenue changes by segment, but I would just like to briefly highlight the charts on this page which illustrate the auto/mobile segment representing 50% of our total revenue during Q2 of 2013 as each of our traditional segments grew during the quarter.

Looking at profitability by segment, our traditional segments delivered 64% of operating income in the quarter, an increase from 57% in Q2 of 2012. Outdoor and Aviation, each contributed an increasing proportion of the operating profit in the current year due to revenue growth.

I'd like to briefly discuss year-over-year gross margin changes by segment. Total corporate gross margin declined by 307 basis points in the quarter with all segments declining. The biggest driver was an Auto/Mobile gross margin decline of 620 basis points, which is primarily attributed to the $21 million royalty benefit booked in Q2 of 2012.

Marine and Fitness gross margins declined 740 and 390 basis points respectively, due to product mix in the quarter. Marine continued to discount older products, which pressured margins, though they did improve sequentially as our new products shipped. And total corporate operating margin declined 400 basis points due to the $21 million royalty benefit booked in Q2 2012 and the increased R&D spending within every segment.

Looking briefly at year-to-date metrics, revenue contribution for 2013 is shifting toward our growth segments with Aviation, Outdoor and Fitness each growing in contribution. A similar shift is occurring in operating income as well, with 68% of our year-to-date operating income coming from our traditional segments.

As previously mentioned, Q2 operating expenses decreased by $4 million on a year-over-year basis from $218 million in Q2 of 2012 to $214 million in Q2 of 2013, while increasing 30 basis points as a percentage of sales.

R&D was the only expense category that increased with the $16 million year-over-year impact. This represented a 260 basis point impact as R&D increased to 14% of sales. We continue to invest in innovation and grow our engineering work force with a heavy emphasis on Aviation currently.

Our advertising spending decreased $9 million over the year ago quarter and decreased 110 basis points as a percentage of sales at 4% in Q2 2013. Much of the decrease was related to declining volumes in PND, and we will continue to scale our advertising expense to match our revenue trends.

SG&A decreased $11 million compared to a year ago quarter declining 120 basis points as a percentage of sales to 13%. This decrease is primarily attributable to a legal settlement and related fees that were recorded in Q2 of 2012.

Moving next to balance sheet and cash flow, we ended the quarter with cash and marketable securities of just over $2.7 billion, which is consistent with Q1 this year. Accounts receivable increased sequentially to $484 million due to the seasonality of the quarter. Accounts receivable accounted for 66 days of sales compared to 64 days of sales in the first quarter of 2013 and 62 days of sales in the second quarter of 2012.

Our inventory balance decreased slightly to $383 million on a sequential basis at the close of the second quarter. Our days of inventory were 116 days compared to 119 in the first quarter of 2013, and 98 days in the second quarter of 2012.

And we continue to generate strong free cash flow across our business as cash from operations was $204 million during Q2. CapEx was $18 million during the second quarter. Therefore, we generated free cash flow of $186 million during Q2. Financing activities were a $102 million use of cash during the second quarter due to the June dividend payment and the repurchase of $13 million of company stock.

And a few more items to discuss relative to our Q2 announcement. Our effective tax rate for Q2 2013 was 16.5%, compared to 10.4% in Q2 of 2012. The increased rate was primarily driven by an unfavorable change in income mix by taxing jurisdictions. Similarly, we now expect our full year tax rate to be 15%, an increase from 13.1% in 2012, due to the geographic mix.

And finally, as Cliff previously discussed, we're 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 the forecasted growth within each segment remains very close to our original guidance, we are not updating revenue growth by segment at this point.

As a reminder, we forecasted 5% to 10% growth in Outdoor, Fitness and Marine segments. 10% to 15% growth in Aviation segment, offset by a 15% to 20% decline in our Auto/Mobile segment. Our current revenue forecast does anticipate that Auto/Mobile will be less than 50% of our total revenue during 2013.

This concludes our formal remarks.