PARTICIPANTS

Corporate Participants

Kerri R. Thurston – Director-Investor Relations
Clifton A. Pemble – President, Chief Operating Officer & Director
Kevin S. Rauckman – Chief Financial Officer & Treasurer

Other Participants

Ameet Prabhu-Salgaonker – Analyst, RBC Capital Markets Equity Research
Simona K. Jankowski – Analyst, Goldman Sachs & Co.
Yair Reiner – Analyst, Oppenheimer Securities
John F. Bright – Analyst, Avondale Partners LLC
Charlie Lowell Anderson – Analyst, Dougherty & Co. LLC
Scott P. Sutherland – Analyst, Wedbush Securities, Inc.
Andrew C. Spinola – Analyst, Wells Fargo Advisors LLC
James Faucette – Analyst, Pacific Crest Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Garmin Third Quarter 2012 Earnings Conference Call. [Operator Instructions] As a reminder this conference is being recorded.

I would now like to turn the call over to your host, 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 Third Quarter 2012 Earnings Call. Before we begin, we'd like to send our warmest thoughts to all those on the East Coast that have been and will continue to be affected by Sandy. The Garmin family has made contributions to several organizations which are assisting with relief efforts throughout the region.

Looking now at the quarter, please note that a copy of the press release concerning this earnings call is available at Garmin's Investor Relations site on the Internet at garmin.com/stock. Additionally, this call is being broadcast live on the Internet. Note that this webcast does include slides which can be viewed during the call via our website and an archive of the webcast will be available until December 31. A transcript will be available on the website under the Events Calendar tab.

This earnings call includes projections and other forward-looking statements regarding Garmin Limited. Any statements regarding our future financial position, revenues, earnings, market shares, product introductions, future demand for our products and objectives are forward-looking. 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. The information concerning these risk factors is contained in our Form 10-K for the year ended December 31, 2011 filed with the SEC.

Attending today's call on behalf of Garmin Limited are Dr. Min Kao, Chairman and Chief Executive Officer; Cliff Pemble, President and Chief Operating Officer and Kevin Rauckman, Chief Financial Officer and Treasurer. The presenters for this morning's call are Cliff and Kevin.

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

Clifton A. Pemble, President, Chief Operating Officer & Director

Thank you, Kerri, and good morning, everyone. As we announced earlier this morning, Garmin delivered revenue growth and strong margin performance resulting in pro forma EPS growth in the third quarter. Consolidated revenues increased 1% year-over-year to $672 million, driven by gains in the Outdoor and Aviation segments. Our traditional markets of Aviation, Marine, Outdoor and Fitness contributed 43% of the total revenue mix and 59% of the total operating income for the quarter.

Gross margins improved to 53% in the quarter. Operating margins also improved to 24% from 22% in the prior year as operating expenses were essentially flat. Revenue growth combined with improved margins resulted in both operating income and pro forma EPS growth.

Operating income for the quarter grew 9% to $160 million while pro forma EPS was $0.74, a 4% improvement over the prior year. We sold approximately 3.7 million units in the quarter, which is up 7% year-over-year as Auto OEMs and Outdoor volumes increased.

In light of our third quarter results, we are increasing our full year pro forma EPS guidance. We now expect our EPS to fall in the range of $2.75 on the low end to $2.90 on the high end. Kevin will provide additional insights later.

Next, I'll walk you through the financial and strategic highlights for each segment. In the Marine segment, revenue declined 7% driven by weak conditions outside of the Americas, particularly in the European market. In contrast, we experienced modest growth in the Americas. Favorable product mix led to higher gross margin and gross profit which more than offset the impact of lower sales. The high-end boat market continues to struggle due to weak economic conditions around the world. We anticipate these conditions will persist into 2013 dampening the near-term growth prospects in the marine market. However, we're not allowing the poor conditions to distract us from our growth strategy in the segment.

In the third quarter, we announced the acquisition of Nexus Marine, giving us an immediate presence in the sailboat instrumentation market where Nexus is a highly respected brand. Additionally, we continue to invest in new product development in order to gain share and to better position ourselves for growth when economic conditions improve.

In Aviation, we posted revenue growth of 3% as improved OEM deliveries offset weakness in retrofit and portable products. As we have highlighted in prior quarters, operating margin is trending below historical norms as we invest in aircraft certification programs that will reach the market in 2013 and beyond. We currently have six announced cockpits slated for delivery in the coming year which will generate new revenue and growth for the future. Note that this morning's press release mentioned five programs that will be completed in 2013, but with the recent announcements factored in, the number is now six.

During the quarter, we announced two additional two cockpit wins that highlight the progress we are making to expand our presence in the OEM market. Just this week, Cessna announced that our G5000 integrated flight deck has been chosen for the upgraded Citation Sovereign. And earlier in the quarter, we announced a new relationship with AgustaWestland who selected a G1000H for the updated 119 model helicopter. Both the Sovereign and the 119 are scheduled for certification in 2013.

I also want to mention that Garmin was ranked #1 in product support by Aviation International News for the ninth consecutive year. This is an incredible accomplishment and highlights that outstanding product support is one of our strongest differentiators as we compete against incumbents in the segment. I want to congratulate our Aviation Product Support team. The recognition by Aviation International News is certainly well deserved.

The Outdoor segment continued to deliver strong results in the quarter with 11% revenue growth and 17% operating income growth. The improved results can be attributed to our golf line-up, our dog tracking and training portfolio and our recently introduced fēnix, which is a GPS-enabled watch for hunters, hikers and outdoor enthusiasts who generally like to blaze their own trails.

In the third quarter, we delivered our Alpha Track and Train System which combines robust GPS tracking and mapping capability from Garmin with proven electronic training from our Tri-Tronics division. Initial reviews and field tests have been positive, and we anticipate the product will do well throughout this hunting season.

Looking next at the Fitness segment, revenue declined 6% though we were able to generate gross margin and operating income growth on a year-over-year basis. As we mentioned in the past, revenue and margin performance are linked to variability in our product cycle. In both the second and third quarter of 2011, we experienced strong demand for the newly released Forerunner 610, while discounts on the end-of-life Forerunner 305 drove additional volumes at the low end of the market that negatively impacted margins.

This year we saw continued growth in our cycling and multi-sport product lines. However, it was not enough to offset the year-over-year decline in running products. During the quarter, we launched our latest running watch, the Forerunner 10. Forerunner 10 is a value-priced watch at $129 and is an affordable and intuitive solution for runners, joggers and walkers of all levels. Early response to the products has been positive with great reviews and strong initial orders. We are confident that the Forerunner 10 will help us close the gap left by the Forerunner 305 at the low-end of the market.

In our Auto/Mobile segment, revenue was flat. However, strong margin performance and lower expenses in the segment resulted in a 16% increase in operating profit. Market share also improved in the third quarter when compared to 2011. We estimate our share in North America exceeds 70%, while European market share is in the low to mid 30% range.

Our outlook in the PND market remains unchanged with units and value declining approximately 10% to 15% for the year. While the broader market has continued to decline, share gains have allowed us to significantly outperform the market.

During the quarter, we introduced a new member of our dēzl product family with a large 7-inch display designed specifically for trucks and RVs where specialized needs drive higher ASPs and stronger margins.

We also updated our StreetPilot and Navigon Mobile applications with public transit features providing mobile phone users with a complete solution for both automotive and pedestrian navigation. These additional features serve to further differentiate our applications and drive consumer adoption.

Before turning the call over to Kevin, I want to provide a brief update on the Auto OEM market. We launched the next-generation navigation solution with Chrysler incorporating advanced features such as 3D mapping, trip planning and multi-route views. These enhancements will be available on select 2013 Chrysler and Dodge models.

Also in the third quarter, we shipped our first fully integrated infotainment solution to Suzuki for their 2013 SX4 Grand Vitara and Kizachi models. We are excited to see these models reach Suzuki dealers in markets around the world including North America, Europe, Australia, New Zealand and Russia.

Now Kevin will walk us through the financial results. Kevin?

Kevin S. Rauckman, Chief Financial Officer & Treasurer

Well, thank you, Cliff. Good morning, everyone. I'd like to begin by reviewing our income statement, then move to the balance sheet and cash flow statement, finally concluding with comments regarding our full-year 2012 expectations.

As Cliff mentioned, we posted revenue of $672 million for the quarter, with the pro forma net income of $146 million. Our pro forma EPS was $0.74 per share which excludes the foreign currency loss. Our revenue represents an increase of 1% year-over-year. Gross margin came in at 53%, which was a 180 basis point improvement from prior year. I will discuss margin results in further detail by segment.

Operating margin was 24%, up 170 basis points from the prior year. The components of this were the gross margin favorability of 180 basis points offset by an unfavorable operating expense impact of 10 basis points. Total operating expenses increased by only $2 million in the current quarter, with a $10 million increase in R&D offset by improvements in advertising and SG&A. Each of these expense categories will be discussed further on a later slide.

Our pro forma EPS of $0.74 represents a 4% increase year-over-year driven by the increasing revenues and improved gross and operating margins. Units shipped increased 7% year-over-year as 3.7 units were delivered during the quarter.

According to U.S. GAAP, we must defer revenue on certain products, and this table summarizes the net impact of the deferral and amortization of revenue and related costs in third quarter 2012 and 2011. In the current quarter, we deferred on a net basis approximately $20 million of revenues resulting in $0.07 of tax affected deferred EPS during the quarter. In the third quarter of 2011, we deferred net revenue of $24 million or $0.08 of tax affected EPS. While we are deferring revenue according to U.S. GAAP, we are collecting the cash at time of sale as reflected in the statement of cash flows. We expect to have a negative revenue and EPS impact due to deferrals in the fourth quarter that do not expect the impact to be as significant as the amount that we deferred during the same period in 2011.

In total, our revenues increased 1% during the third quarter with Outdoor and Aviation contributing most of the growth. During Q3, the Auto/Mobile segment revenues were flat as volume growth was offset by a slight decline in average selling price. Volume growth was driven by market share gains and strengthening results with our Auto OEM partners. Our Outdoor segment posted the strongest revenue growth at 11%, due primarily to our GPS -enabled golf products, growth in our dog tracking and training portfolio, and strong consumer reception for our fēnix product.

Fitness segment posted a 6% revenue decrease when compared to Q3 2011. This slowdown resulted from a strong Q3 2011 when we were heavily promoting the Forerunner 305 as the product reached the end of its life cycle and we're also fulfilling orders for the Forerunner 610. We hope to see improving results in Q4 driven primarily or partially by the launch of the Forerunner 10.

Aviation segment revenues increased 3% compared to Q3 2011 with growth in OEM, partially offset by a slowdown in Retrofit and portable products. Our Marine segment revenues decreased 7% compared to Q3 2011 as both the aftermarket and OEM markets slowed down due to a global decline in the marine electronics market.

During Q3, both the Americas and APAC posted revenue growth with a partial offset due to the decline in EMEA. The decline in EMEA is the result of difficult macroeconomic conditions in most of the region. For Q3 2012, the Americas represented 57% of revenue compared to 53% in Q3 2011. EMEA decreased from 39% of total revenue in Q3 to 33% in Q3 2012 while APAC increased from 8% to 10% over the same periods.

The Auto/Mobile segment represented 57% of our total revenue during Q3 2012, down slightly from 58%. Outdoor grew to 16% of revenues in the quarter, an increase from 14% in 2011. Due to the improved profitability in Auto/Mobile in the third quarter of 2012, the operating income contribution of this segment increased to 41% from 38% of the prior year.

In absolute dollars, our traditional segments of Aviation, Marine, Outdoor and Fitness contributed $95 million of operating income in the quarter, a 4% increase over third quarter of 2011 even as we invest heavily in future OEM opportunities in Marine and Aviation.

Looking next at margins, Q3 Auto/Mobile gross margin and operating margin were 43% and 17% respectively. Gross margins were stable as deferred revenues became less of a year-over-year impact in the quarter. Operating margin improvement resulted from decreasing advertising and SG&A expenses in the segment.

Q3 Outdoor gross margin was 69%, up from 66% in Q3 2011. Operating margin was 46%, an improvement from 44% in the year ago quarter, as improved gross margins were partially offset by a slight increase in operating expenses.

Q3 Fitness gross margin was 65%, up from 60% of the year ago quarter when we were heavily discounting the Forerunner 305. Operating margin was 33%, again, up from 30% of the year ago quarter as improved gross margins were partially offset by increased advertising and R&D costs.

Q3 Marine gross margin was 64%, compared to 55% of the year ago quarter as product mix shifted toward higher margin products, and we participated in fewer promotional activities. Our operating margin was 19%, down from 21% a year ago, as the gross margin improvement continued to be offset by increased R&D expenses to support a long-term Marine OEM strategy and new product launches scheduled for next year.

And finally, our Q3 Aviation gross margin was 69%, up from 66% in Q3 2011. The operating margins was 23% for the quarter, down from 27% in the prior year as gross margin improvement was offset by increased R&D expense associated with the new OEM programs that will begin to contribute to revenue in 2013, as well as increased SG&A costs due to a bad debt credit booked in Q3 2011.

Q3 operating expenses increased by $2 million on a year-over-year basis from $197 million in Q3 2011 to $199 million in Q3 2012, an increase of only 10 basis points as a percentage of sales. R&D increased $10 million year-over-year in Q3 and 130 basis points to 12% of sales as head count increased and we continued to invest in OEM opportunities. Our advertising spending decreased $5 million over the year-ago quarter and decreased 80 basis points as a percent of sales to 4% in Q3 of 2012. This was largely driven by decreasing cooperative advertising. SG&A decreased $2 million compared to the year ago quarter and 40 basis points to 13% of sales. This decrease is primarily attributable to reduced commission expenses. We have now anniversaried our major acquisitions in 2011 and are pleased to see this flattening of SG&A expense.

Moving next to the balance sheet, we ended the quarter with cash and marketable securities of over $2.7 billion. Our accounts receivable increased sequentially to $509 million, but fell slightly on a year-over-year basis, due to continued sales strength in the third quarter. Accounts receivable accounted for approximately 65 days of sales when calculated on a trailing four quarters compared to 74 days of sales in the third quarter of 2011.

Our inventory balances increased to $443 million on a sequential basis at the close of Q3 as we prepare for the seasonally strong fourth quarter. Our days of inventory metric was 125 days which was flat to the third quarter of 2011.

The dividend payable now reflects two remaining quarterly payments of $0.45 per share which was approved by our shareholders on June 1 at the annual meeting.

Our deferred revenue balance has continued to grow. Net of deferred cost, it represents approximately $1.43 of deferred EPS.

We continue to generate free cash flow across our business as cash from operations was $165 million during Q3. CapEx was $9 million during the quarter; therefore we generated free cash flow during Q3 of $155 million. Cash flow invested during Q3 was $104 million which includes the $9 million of CapEx and $93 million of net purchases of marketable securities.

Financing activities were $87 million use of cash during Q3 due primarily to the dividend payment for September.

We earned an average of 1.2% on all cash and marketable securities balances during the quarter.

With our strong free cash flow generation year-to-date, we are making good progress toward our forecast of $650 million which will continue to fund our annualized dividend of $1.80 per share or approximately $350 million use of cash. We also continue to pursue acquisitions in adjacent niche markets and tuck-in technologies which fit with our core markets. As have been Garmin's practices, the acquisitions will be evaluated by technology, values compatibility and strategic fit within Garmin.

Our tax rate for Q3, 2012 was 13.7% due to the revenue mix by geography and segment. We expect the full-year 2012 rates to be approximately 13%.

And finally, given our strong EPS performance in Q3, we are again raising our full-year EPS guidance to $2.75 to $2.90. This continues to incorporate some uncertainties regarding the European markets and consumer spending as we head into the holiday season.

This ends our formal comments for the quarter.

