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

Rich F. Valera – Analyst, Needham & Co. LLC
Charlie Lowell Anderson – Analyst, Dougherty & Co. LLC
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Jonathan Ho – Analyst, William Blair & Co. LLC
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the Garmin Limited Fourth Quarter 2012 Earnings Conference Call. As a reminder today's call is being recorded.

At this time, I'd like to turn the call over to Ms. Kerri Thurston. Please go ahead, madam.

Kerri R. Thurston, Director-Investor Relations

Thank you and good morning, everyone. We'd like to welcome you to Garmin Limited's Fourth Quarter 2012 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 until March 29.

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 shares, 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. The information concerning these risk factors is contained in our Form 10-K for the year ended December 31, 2011, which is on file with the Securities and Exchange Commission. Our 2012 filing will occur next week.

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

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 business trends for Garmin decelerated in the fourth quarter with consolidated revenues down 16% year-over-year. Gross margins remained strong at 48.6% and operating expenses declined 4% in the period. However, operating margins declined to 19.5% due to the weakness in revenues. As a group, our traditional market segments of Aviation, Marine, Outdoor, and Fitness contributed 66% of our total operating income in the quarter.

We generated $163 million in free cash flow during the quarter, resulting in a cash balance of just under $2.9 billion.

While these results did not meet our expectations for the quarter, we were pleased with our continued strong profitability and cash flow generation.

Reviewing the full year, consolidated revenue declined 2%. However, pro forma EPS grew 4% as margins exceeded the expectations we established at the beginning of the year. Operating income grew 9% to $604 million, with all segments excluding Marine contributing to the growth.

As a group, our traditional market segments posted revenue growth and contributed over $1.2 billion in total revenue for the year. The revenue growth in these segments combined with our strong margin profiles generated 63% of our operating income.

We delivered approximately 15.4 million units in 2012, a decline of only 3% year-over-year. Lower PND unit shipments were partially offset by growth in Auto OEM, Outdoor and Fitness.

We generated $646 million in free cash flow in the year, which was partially used to fund our quarterly dividend and small acquisitions throughout 2012.

Next, I will review each of our business segments highlighting 2012 performance, 2013 outlook, and a summary of long-term strategic initiatives for each one.

Looking first at the Marine segment. On a full-year basis, we reported year-over-year revenue decline of 6%, driven primarily by weak market conditions in Europe. Operating income declined significantly, as we invested heavily in Research and Development to deliver a growing portfolio of products. Though this has reduced segment profitability in the short term, we expect to see improved revenue performance in 2013, as a result of this investment. During the year we acquired Nexus Marine resulting in an expansion of our presence in the sailing market, which is an area of strategic focused for our Marine segment.

For 2013, we are targeting revenue growth of 5% to 10% as we anticipate market conditions will improve, and recent product introductions will generate additional revenue. These new products include our recently announced glass helms, chartplotters, and fishfinders, which deliver improved performance through the addition of GLONASS, and enhanced sonar capabilities. We also introduced the quatix, a watch that includes compelling marine features, rugged utility, and the versatility of wireless connectivity to the Garmin Marine network. The quatix is another great example of how we successfully leverage products and technologies across our business segments.

In the long-term our objective is to increase our market share across the recreational boating industry. We will continue to integrate and leverage our acquisitions in this segment, resulting in a broader range of products for our customers. And finally, we will focus on improving the operating margin performance over the long-term. While we expect inherent improvements due to revenue growth, we also see opportunities to improve profitability through increased efficiencies in the Marine segment.

Turning next to Aviation, we reported year-over-year revenue growth of 2%. Operating income also grew 2% for the year due to increased sales, and improved gross margins, which offset higher operating expenses in the segment.

During 2012 we secured a number of significant wins in the Part 25 Business Jet Market. Cessna selected our G5000 system for the Citation Sovereign slated to enter the market in 2013. Cessna also selected the G5000 for the Citation Longitude, a newly designed aircraft that will enter the market in 2017. In addition, Bombardier selected the G5000 for the new Learjet 70 and 75, which will also enter into service in 2013.

The utility and flexibility of our integrated cockpit systems has created opportunities outside of our traditional Aviation business. Northrop Grumman selected Garmin to provide the integrated flight deck for the optionally-piloted Firebird, this is a commercial off-the-shelf solution that offers the required capabilities at significant time and cost savings to the manufacturer.

Also in 2012, we launched several new system components that position us to secure more content in future OEM and retrofit installations. These components include a solid state weather radar, ADS-B, and enhanced TCAS [Traffic Collision Avoidance System] solutions.

In 2013, we are targeting revenue growth of 10% to 15% in the Aviation segment. We anticipate the industry will remain relatively flat with Garmin's growth driven by numerous certifications that expand our share in the business jet market. In addition, we anticipate that recent product introductions will contribute to the growth.

Longer-term, our growth initiatives are focused on continued development of our G3000 and G5000 platforms with OEM partners, which serves as the foundation of our growth in 2013 and beyond. Identifying and capitalizing on additional retrofit opportunities as well as commercial off-the-shelf opportunities within the military and government sectors. Further share gains in the helicopter market. Capitalizing on opportunities created by the FAA's transformation of the National Airspace System, from a ground-based system of air traffic control to a satellite-based system of air traffic management.

Turning next to Outdoor, in the Outdoor segment we reported year-over-year revenue growth of 11%, which was primarily driven by strong demand for golf and dog tracking products. The growth was further enhanced by a full-year of revenue contribution from Tri-Tronics, which we acquired in the second half of 2011.

Product highlights in the year include the fēnix wrist watch - a rugged, yet stylish device designed with the active outdoorsman featuring GPS navigation with altimeter, barometer and compass functions. The Approach S3 golf watch - offering unmatched convenience, simplicity and capability through the combination of our wearable device platform, touch screen and a built-in worldwide course database. And finally the Alpha Track and Train System - integrating the best in class technologies of Garmin and Tri-Tronics into a single device for the sporting dog market.

Looking at 2013, we expect revenue growth of 5% to 10%, driven by both ongoing momentum from existing products as well as recently introduced products including the BarkLimiter and Delta Series for the pet market. These new electronic training aids expand our addressable market and capitalize on the correction technology of Tri-Tronics to deliver superior yet affordable products for the pet owner.

Long-term we will continue to create new opportunities by identifying adjacent markets and product categories. We will maintain our focus on utility, content, and innovative form factors to engage both new and repeat customers in the segment, and embrace the opportunities created by mobile platforms to expand our market reach.

In the Fitness segment, we reported year-over-year revenue growth of 8%. While this is not as robust as prior years, we maintained our leadership position in the GPS-enabled fitness category due to our strong existing product portfolio, and the introduction of the Forerunner 10, targeting entry-level and value conscious consumers. The return to double-digit growth in the fourth quarter gives us confidence that the market remains underpenetrated.

In 2013, we are targeting revenue growth of 5% to 10% in the Fitness segment. We plan to accomplish this by further penetrating the cycling market with our recently launched Edge 510 and 810, which offer unique connectivity features that our customers have requested. We continue to make progress with our Vector Power Meter, and anticipate that it will be available midyear. In addition, we will continue to deliver further innovation across the Fitness category that will appeal to a broad range of consumers whether shopping for a basic device or a full-featured multisport product.

Looking beyond 2013, we believe the Fitness segment will continue to grow as society becomes increasingly health conscious and data driven. We will focus on delivering compelling form factors, and innovative products to the market, offering a complete solution of device, wireless connectivity, measurement sensors, and a well developed web portal. We will continue to build the Garmin Connect community and social networking capability amongst our users. We also will enhance our devices with best-in-class peripheral sensors to expand our addressable market, and leverage our knowledge of hardware, software, and connectivity.

Looking finally at the Auto/Mobile segment, revenues declined 6% for the year as our strong market share gains could not offset the secular declines in the PND industry, which accelerated in the fourth quarter. We estimate that we exited 2012 with greater than 70% share in North America, and approximately 32% share in EMEA.

Though the industry headwinds were challenging, we achieved strong margins which generated over $220 million of operating income for the year. The sustained profitability of the segment highlights the value of market share gains within the segment.

Also in 2012 we announced our first Tier 1 relationship with Suzuki, providing a complete infotainment head unit system for the vehicle. While the opportunity was somewhat diminished by Suzuki's exit of the North American market, we continue to deliver equipment in Europe, Australia, Russia, India, Canada and Mexico. Also on the OEM front, we continued our successful partnership with Chrysler launching Garmin navigation on the Dodge Dart, and extending our geographic reach into China and Japan.

Looking ahead, we expect PND unit deliveries to continue to decline in 2013, driving revenues down 15% to 20%. We will maintain our market share leadership and focus on maximizing our profitability.

We will continue to invest in auto OEM opportunities in 2013, leveraging our K2 infotainment platform that was introduced at CES this past January. The K2 digital cockpit was nominated by CNET for best of show, and garnered significant media coverage, and consumer attention. We believe it represents one of the most intuitive, yet full featured infotainment systems offered to date.

Beyond 2013 we'll be focusing on expanding our auto OEM business through additional program wins as infotainment and navigation become an integral part of the vehiclein capitalizing on niche opportunities in fleet management, over-the-road, trucking, and other specialty markets that offer high margin profiles.

Finally, turning to guidance given our revenue outlook and expectations for each segment, we're projecting revenues of $2.5 million to $2.6 billion in 2013, with gross margins stable to slightly increasing from 2012 levels. We're projecting operating income between $480 million and $500 million, with operating margins of 19% to 20%. Factoring in an anticipated effective tax rate of 14% which is a percentage point higher than the previous year results in a forecasted 2013 earnings per share range of $2.30 to $2.40.

While it appears that 2013 will be a challenging year, we remain highly profitable with strong cash flow generation that allows us to adequately fund our growing business and generate long-term shareholder value through these initiatives. We remain committed to an attractive dividend yield, and our recently announced share repurchase program will return even more value to our shareholders.

That concludes my remarks. Kevin will now walk us through our Q4 and full-year financials in more detail. Kevin?

Kevin S. Rauckman, Chief Financial Officer & Treasurer

Thanks Cliff, and good morning, everyone.

I'd like to begin by reviewing our income statement for the quarter, the full year and then segment results, move to the balance sheet and cash flow statement, and finally conclude with some comments regarding our full-year 2013 expectations.

We posted revenue of $769 million for the quarter with pro forma net income of $133 million. Our pro forma EPS was $0.68 per share, which excludes foreign currency loss during the period. Our revenue represents a decrease of 16% year-over-year.

Gross margin came in at 49%, which was a 90 basis point improvement from the prior year. I'll discuss margin results in further detail by segment.

Operating margin was 19.5%, down 250 basis points from the prior year. The components of this were gross margins 90 bps favorable, offset by unfavorable operating expense impact of 340 basis points. Total operating expenses decreased by $10 million in the quarter, driven by a $9 million decrease in advertising. Each of the operating expense categories will be discussed further on a later slide.

The pro forma EPS of $0.68 represents a 29% decrease year-over-year, driven by decreasing revenues, declining operating margins, and an increase in our effective tax rate, which reduced earnings per share by $0.05.

Units shipped decreased 17% year-over-year, as just over 5 million units were delivered during the quarter.

Looking at full year results, we posted revenue of $2.7 billion for the year with net income of $542 million. Our pro forma EPS was $2.85 per share, which excludes foreign currency losses. Our revenue decreased 2% year-over-year, while pro forma EPS increased 4%, when excluding FX.

Our gross margin at 53% was a 450 basis point improvement over the prior year.

Operating income increased 9% to $604 million, compared to $554 million in 2011. Our operating margin was 22.2%, up 210 basis points from 20.1% last year. The pro forma EPS of $2.85 was a 4% increase year-over-year on increasing revenues, and improved growth in operating margins.

And our units shipped during 2012 were down 3% year-over-year as 15.4 million units were delivered.

In total, our revenues decreased 16% during fourth quarter and 2% for the full year. During Q4, we experienced a 25% revenue decline within the Auto/Mobile segment as volume declines steepened and our product cycle created a difficult comparison. Our Outdoor segment posted a 2% decline as we compared against a very strong Q4 2011 when we generated 35% growth. The Fitness segment returned to growth with a 10% revenue increase when compared to Q4 2011 on the strength of our running line up, including the Forerunner 10. Aviation segment revenues decreased 2% compared to Q4 of 2011, and Marine segment revenues decreased 9% compared to the fourth quarter of 2011 due to ongoing weakness in Europe.

During Q4, all geographies declined, though APAC only declined slightly. For the full-year Americas declined 1%, while EMEA declined 4%, and this was partially offset by growth in the APAC region. For 2012 the Americas represented 56% of our revenue, EMEA represented 35%, and Asia 9% - very consistent with 2011.

The Auto/Mobile segment represented 57% of our total revenue during the fourth quarter of 2012, down from 64% in Q4 2011. Outdoor and Fitness grew to 16% and 14% of revenues in the quarter respectively, an increase from 13% and 10% in the fourth quarter of 2011.

On an operating income basis, Fitness and Aviation increased their contribution percentage, while Marine posted a loss in the quarter due to significant R&D investment and low revenues in the seasonably weak fourth quarter. The Auto/Mobile contribution declined on the significant revenue decline.

On a full-year basis, Auto/Mobile revenue contribution declined from 58% in 2011 to 55% in 2012, with gains in Outdoor, Fitness and Aviation, which contributed 15%, 12% and 11% respectively.

The operating income contribution of the Auto/Mobile segment increased to 36% in 2012 compared to 29% in 2011, due to the improved margins in the segment related primarily to the recognition of high-margin deferred revenue.

Q4 Auto/Mobile gross margin and operating margin were 38% and 12% respectively. Gross margins were stable, as a slight ASP decline associated with our product cycle was offset by lesser year-over-year impact from the deferred revenue. Operating margin declined slightly as operating expense reductions were not enough to offset the revenue decline.

Q4 Outdoor gross margin was 62%, down from 68% in Q4 2011. Operating margin was 39%, a decline from 49% of the year ago quarter as ASPs declined and margins contracted due to lifecycle pricing on many of our more popular devices.

Q4 Fitness gross margin was 60%, down from 64% in the year ago quarter, as product mix shifted towards the lower margin Forerunner 10. I do want to note that for the full year gross margin was up 260 basis points as full year mix was positive. In 2013, we will have product introductions across the price spectrum, so we don't anticipate a significant gross margin decline in Fitness. Operating margins was 34%, down from 43% in the year ago quarter, as gross margins declined and operating expenses increased due to the allocation of SG&A and advertising expense.

Q4 Marine gross margin was 51%, compared to 60% in the year ago quarter, as product mix shifted toward lower margin products, and we offered promotional discounts on end-of-life products. Operating margin was negative 4%, down from 22% a year ago, as the gross margin declined and we increased R&D investment to support our long-term Marine OEM and aftermarket strategy, as Cliff discussed earlier.

Q4 Aviation gross margin was 73%, up from 65% in fourth quarter of 2011 when we recorded an OEM program contribution that negatively impacted gross margin. Operating margin was 26% for the quarter, up from 18% in the prior year due to the gross margin improvement.

Q4 operating expenses decreased by $10 million, or 4% on a year-over-year basis, from $234 million to $224 million in fourth quarter of 2012. R&D decreased $2 million year-over-year in the fourth quarter, but increased 150 basis points to 11% of sales as head count increased and we continued to invest in OEM opportunities across multiple segments. Our advertising spending decreased $9 million over the year ago quarter, and held consistent as a percentage of sales at 6%. This was largely driven by decreased cooperative advertising. SG&A increased only slightly in absolute dollars compared to the year ago quarter, but decreased by 190 basis points to 12% of sales.

Looking next at the balance sheet, we ended the quarter with cash and marketable securities of almost $2.9 billion. Our accounts receivable increased sequentially to $604 million, this is relatively stable year-over-year. Accounts receivable accounted for approximately 81 days of sales when calculated on a trailing four quarters. And as of early February, we've now collected $300 million of this year-end balance.

Our inventory balances decreased to $389 million on a sequential basis at the close of fourth quarter as we exited the seasonally strong fourth quarter. Our days of inventory metric was 117 days, up slightly from 102 days in the fourth quarter of 2011.

The dividend payable continues to reflect two remaining quarterly payments of $0.45 per share, which was approved by our shareholders on June 1 last year at the Annual Meeting, as our December 31 payment was not made prior to the close of our fiscal year.

Our deferred revenue balances continued to grow. Net of deferred cost, it represents approximately $1.55 per share of deferred earnings per share.

Looking next to cash, we continue to generate free cash flow across our business as cash from operations was $175 million during the fourth quarter. CapEx came in at $12 million during the fourth quarter. Therefore, we generated free cash flow during Q4 of $163 million. Cash flow invested during Q4 was $192 million use of cash, including the $12 million in CapEx, $175 million net purchase of marketable securities, and $5 million of acquisitions. Financing activities were a $3 million use of cash during fourth quarter as the dividend payment fell in the first quarter of 2013, as previously mentioned. We earned an average of 1.5% on our cash and marketable security balances during Q4.

We expect a strong free cash flow generation year to continue in 2013, and with it we plan to fund an ongoing quarterly dividend of $0.45, fund a share repurchase program, as recently approved by the board of up to $300 million, and pursue acquisitions in adjacent niche markets and tuck-in technologies which fit with our core markets.

As expected, our tax rate for 2012 was just over 13%, but this was an increase from 10.8% in 2011. We currently anticipate that our 2013 tax rate will be 14% as benefit from the retroactive R&D tax credit is offset by a geographic income mix.

And finally, Cliff has reviewed our 2013 guidance, but I'd just further highlight that we had four solid growth segments that we anticipate will represent over 50% of our revenue during 2013. As highlighted in our guidance, we'll continue to invest in 2013 for long-term growth opportunities across the entire business, positioning us well for the future.

Well this concludes our formal remarks. We'll now move to a period of Q&A.