PARTICIPANTS

Corporate Participants

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

Other Participants

Yair Reiner – Analyst, Oppenheimer & Co., Inc.
Charles L. Anderson – Analyst, Dougherty & Company LLC
Simona K. Jankowski – Analyst, Goldman Sachs & Co.
John F. Bright – Analyst, Avondale Partners LLC
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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to today's Garmin Limited Fourth Quarter 2013 Earnings 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, ma'am.

Kerri R. Thurston, Director-Investor Relations

Good morning, everyone. We'd like to welcome you to Garmin Limited's fourth quarter 2013 earnings call. Please note that the earnings press release and the related slides are available on Garmin's Investor Relations site on the Internet at www.garmin.com/stock. An archive of the webcast and a related transcript will 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, which is filed with the Securities and Exchange Commission. We will be filing our 2013 10-K later today.

Presenting 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 and Chief Executive Officer

Thank you, Kerri, and good morning, everyone. As announced earlier today, Garmin reported strong fourth quarter revenue and margin performance, which contributed to a 12% increase in pro forma EPS. Outdoor, fitness, aviation and marine increased 14% on a combined basis, which largely offset lower revenues in auto/mobile. These growth segments represented 50% of our revenue in the holiday quarter.

Gross and operating margins improved year-over-year to 52% and 23% respectively. Gross margin strength was driven by the revenue mix shifting towards our higher margin segments and a lower amount of revenue deferrals on a year-over-year basis. Operating income increased 16% due to stronger gross margins combined with expense control. This allowed us to maintain our emphasis on R&D while keeping overall expenses relatively flat on a year-over-year basis. As a result, operating income grew in each of our five business segments and we generated a $135 million in free cash flow during the quarter. We are pleased with our Q4 performance and it gives us a strong foundation to build upon as we begin 2014.

Looking briefly at full-year performance, we achieved record revenue in our growth segments. However, ongoing declines in the PND category resulted in lower consolidated revenue as we expected, down 3% for the year. On a combined basis, our growth segments contributed over $1.3 billion in revenue for the year or 51% of the total and generated 67% of our operating income.

Gross and operating margins were stable compared to 2012, resulting in strong profit generation despite pressure in the PND market and an increased level of R&D spending during the year.

Kevin will further discuss margins in his remarks.

For the full year, we generated $574 million of free cash flow exceeding our expectations of $525 million. The cash was primarily used to fund our quarterly dividend and share repurchase program throughout 2013.

So next we'll review each of our business segments highlighting 2013 performance, the 2014 outlook and a brief summary of long-term strategic initiatives.

Starting first with outdoor, we reported year-over-year revenue growth of 2% with growth accelerating in the fourth quarter due to new product introductions. Wearables, golf products, dog tracking and training and action cameras contributed to this growth. The outdoor segment continued to generate strong gross and operating margins in 2013 at 64% and 39% respectively. The most significant product introduction in 2013 was the VIRB action camera series which contributed to the stronger growth in the fourth quarter. Looking at 2014, we expect revenue growth of 10% to 15% driven by growth in action cameras, golf, and dog tracking and training devices.

Beyond 2014, we will focus on new opportunities in adjacent markets where we can leverage our brand and global distribution. We will make additional investments in the action camera market to broaden our product line and drive market share gains. In addition, we will maintain our focus on utility, content and innovative form factors to attract both new and repeat customers, while embracing the opportunities to enhance the user experience via connectivity.

In the fitness segment, we reported year-over-year revenue growth of 11%, which outpaced both our expectations and prior-year growth. We expanded our leadership position in the GPS-enabled fitness category with the introduction of new Edge cycling computers and Forerunner watches. In addition, we expanded our role in the cycling market with the introduction of the Vector power meter.

The return to double-digit growth in the second half of 2013 gives us confidence that the fitness market remains underpenetrated and that our products continue to be well positioned from a competitive perspective. Though we have faced significant competition in recent years, our portfolio of differentiated products has resulted in strong gross and operating margins of 63% and 34% respectively.

In 2014, we are targeting revenue growth of 10% to 15% in the fitness segment. A key component of this growth is the recent launch of the vívofit, and the vívokí activity monitors, which established a new standard for utility and innovation in this emerging product category.

In addition, we plan to further penetrate the cycling and running markets with our recently launched products, and others that are yet to come during the year.

Looking beyond 2014, we believe that opportunities within fitness and wellness will continue to expand as global consumers become increasingly health conscious. 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 compelling web portal. We will leverage the redesigned Garmin Connect website to further expand our community of users with enhanced support for a broad range of activities, and social networking among participants.

Finally, we'll gain share in the activity monitor market by delivering industry-leading utility and form factors that meet the needs of a diverse set of customers.

Turning next to aviation, we reported year-over-year revenue growth of 16%, as both OEM and aftermarket performed well. Operating income increased 20% for the year, ahead of revenue growth, as gross margin improved and expenses were in line with sales. A key achievement in 2013 was the completion of our first Part 25 certifications with Cessna and Bombardier.

In addition, we've launched new or enhanced systems with Embraer, Piper, Bell, and AgustaWestland.

In 2014, we're targeting revenue growth of 10% to 15% in the aviation segment, stable conditions in the OEM market, combined with a full-year of revenue contributions from new platforms will result in growth for OEM products. In addition, we anticipate positive signals in the aftermarket will continue in the coming year and contribute to overall segment growth.

Longer term, our growth initiatives are focused on continued development of our G3000 and G5000 platforms with OEM partners, which is the foundation for long-term market share expansion, identifying aftermarket opportunities, as well as commercial off-the-shelf opportunities within the military and government sector, developing unique technologies that fill gaps in our current product portfolio and capitalizing on opportunities created by the FAA's transformation of the National Aerospace System from a ground-based system of air traffic control to a satellite base system of air traffic management.

Moving next to the marine segment, we reported year-over-year revenue growth of 7%, with accelerated growth in the second half of the year when we delivered a significant number of new products to the market.

Gross and operating margins declined as we face competitive pricing pressure, unfavorable product mix and higher R&D expenses associated with expanding our product portfolio. Though this reduced segment profitability in the short-term, we expect to see revenue growth and improved profitability going forward.

For 2014, we are targeting revenue growth of 10% to 15% in the marine segment, as we anticipate market conditions will improve and recent product introductions will generate new revenue opportunities. New product contributions include a full-year of our glass helm products as well as contributions from new chartplotters and fishfinders, which were introduced late last year and have already been delivered to the market.

In the long-term, our objective is to increase our market share in recreational boating with specific emphasis on fishing and sailing markets. We plan to grow our OEM position by leveraging our full range of products including chartplotters, radar, sonar, autopilots and audio systems.

And finally, through continued innovation and efficiency, we will deliver new products and improve the operating margin performance of our marine business over the long-term.

Looking finally at the auto/mobile segment, revenues declined 13% for the full year, as lower PND revenues were partially offset by growth in OEM and mobile product categories. According to our estimates, we exited the year with approximately 45% market share on a global basis and achieved 81% share in the fourth quarter in the U.S. market, representing an all-time high watermark to Garmin.

Though the industry headwinds were challenging, segment margins remain strong, generating over $188 million of operating income for the year. A key highlight in 2013 was the announcement of our relationship with Mercedes, providing navigation solutions beginning in some 2014 models and all models by 2017.

Looking at 2014, we expect PND unit deliveries to decline in line with 2013 rates, driving revenues down 10% to 15% in the segment. We will focus on market share leadership and maximizing profitability in PNDs, while capitalizing on new opportunities such as Dash cameras and portable HUD solutions. We will continue to invest in auto OEM opportunities leveraging our complete range of capabilities from fully integrated infotainment platforms to navigation-focused software solutions.

Beyond 2014, we will focus on expanding our auto OEM business, through additional program wins, delivering the most intuitive and advanced in-vehicle experience, managing the profitability of the PND segment as the market size continues to decline and capitalizing on niche opportunities in motorcycle, fleet management, over-the-road trucking and RV.

While no single product can offset the trends in the PND market, we're excited about the numerous incremental opportunities to enhance revenue and profitability in 2014. With this in mind, we're projecting revenues of $2.6 billion to $2.7 billion with gross margins increasing to 54% to 55% due to segment mix. We're projecting operating income between $530 million and $565 million with operating margins of approximately 21% as we grow our R&D investment and manage other expenses in line with revenue and opportunity.

Factoring in an anticipated effective tax rate of 17%, 2014 pro forma earnings per share should fall in the range of $2.50 to $2.60 with free cash flow generation of $550 million to $600 million. Given our cash flow outlook, we will propose an increase in the dividend at our upcoming annual meeting and we will participate in share repurchases as market conditions warrant. We believe these actions will result in strong returns for our shareholders over the long-term.

And finally you've seen in our press release that Kevin has decided to change the intense pace he has managed over many years. We wish Kevin, all the best in the future, but we're going to miss him very much. Kevin will offer some additional remarks on his transition in a moment, but I want to take this opportunity to thank you, Kevin, for all you've done for Garmin over the past 15 years.

That concludes my remarks, Kevin will now walk through our Q4 and full year financials in more detail. So Kevin, take it away.

Kevin S. Rauckman, Chief Financial Officer & Treasurer

Thanks, Cliff, and good morning, everyone. I'd like to begin by reviewing our financial results then move to some summary comments on the balance sheet, cash flow, taxes and finally 2014 guidance.

So we posted revenue of $760 million for the quarter with pro forma net income of $150 million. Our pro forma EPS was $0.76 per share excluding the foreign currency gain. Our revenue represents a decrease of just 1% year-over-year. And gross margin came in at 52%, a 330 basis point increase from the prior year, driven by a segment mix and reduced impact from deferred revenues.

Operating margin was 23%, an increase of 320 basis points from the prior year, with gross margin favorability of 330 basis points, offset by an unfavorable operating expense impact of 10 basis points. Total operating expenses decreased by $2 million in the current quarter, with reduced spending in advertising, partially offset by a $10 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 12% increase year-over-year. We shipped 4.5 million units during the quarter, which represents an 11% decrease year-over-year. Our total company average selling price was $169 per unit, up 11% from $152 per unit in the fourth quarter of 2012, driven primarily by segment mix and the reduced revenue deferrals.

Looking at full-year results, we posted revenue of $2.6 billion for the year, with pro forma net income of $514 million, our pro forma EPS was $2.62 per share, which excludes FX gains and $68 million of our income tax reserve releases during the year.

Our revenue decreased 3% year-over-year, and our gross margin was 53%, a 50-basis point improvement over the prior year. Operating income decreased 5% to $574 million, compared to $604 million in 2012.

Our operating margin was 22%, down 40 basis points from last year. The pro forma of $2.62 was down 8% year-over-year. Units shipped were down 10% with 13.9 million units delivered during 2013.

Next, you can see how our fourth quarter revenue breaks down by segment, 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 Q4 of 2013, as each of the non-auto/mobile segments grew during the quarter.

You can see from our profitability mix by segment that our non-auto/mobile segments delivered 69% of operating income in the quarter, an increase from 66% in Q4 of 2012. Fitness, aviation and marine, each contributed an increasing proportion of total operating income in Q4, due to revenue growth, and improving or stable operating margins.

I'd like to briefly discuss year-over-year gross margin changes by segment. Auto/mobile gross margin increased to 40% from 38% in the prior year, primarily due to less deferred high margin revenues. Marine and fitness gross margins improved in the current quarter, due to product mix, shifting towards new products in the quarter.

So our total corporate operating margin improved to 23%, due to the increased gross margin during the period.

Looking briefly at year-to-date metrics, revenue contribution for 2013 shifted toward our growth segments, with marine, aviation, fitness and outdoor each growing in contribution. A similar shift is occurring in operating income with 67% of our 2013 operating income, coming from our non-auto/mobile segments.

As previously mentioned, Q4 operating expenses decreased by $2 million on a year-over-year basis from $224 million in Q4 2012 to $222 million in Q4 of 2013, while increasing 10-basis points as a percent of sales.

R&D increased $10 million year-over-year, this represented 140-basis point impact, as R&D increased to 12% of sales. We continue to invest in innovation and grow our engineering work force, with a heavy emphasis on aviation, outdoor, and fitness.

Our advertising spending decreased $12 million over the year ago quarter and decreased 150 basis points, as a percent of sales to 5% in Q4 of 2013. Much of the decrease was related to declining volumes in PND, as well as reduced media spending. We will continue to scale our advertising expense to match our revenue trends.

SG&A was up $1 million, compared to the year ago quarter, increasing 20 basis points, while holding steady at 12% of sales. We're working diligently to manage these expenses, as our PND market declines.

Next, the balance sheet and cash flow, we ended the quarter with cash and marketable securities of over $2.8 billion. Accounts receivable increased sequentially to $565 million, due to holiday sales. Our accounts receivable accounted for 79 days of sales, compared to 81 days of sales in the fourth quarter of 2012.

Our inventory balance decreased to $382 million on a sequential basis, at the close of fourth quarter, as we exited the stronger holiday quarter. Our days of inventory were 114 days, compared to 117 days in the fourth quarter of 2012.

We continue to generate strong free cash flow across our business, as cash from operations was $150 million during Q4. CapEx was $15 million during the fourth quarter. Therefore, we generated free cash flow of $135 million during the fourth quarter, and our full year free cash flow was $574 million, coming in ahead of forecast.

We repurchased $31 million of company stock and have $241 million still authorized through December of 2014.

A few more items to discuss, relative to our Q4 announcement - Our effective tax rate for Q4 of 2013 was 20%, compared to 16.5% in Q4 2012, the increased rate was primarily driven by an unfavorable change in income mix by taxing jurisdiction, and reduced tax holidays in Taiwan.

Our full year pro forma rate adjusted for the $68 million of reserve releases was 16.8%. We expect our full year rate for 2014 to be approximately 17%, due to the geographic mix of income.

We also announced in our press release this morning that given our strong free cash flow generation we plan to seek shareholder approval for an increased dividend, beginning with the June 2014 calendar quarter.

The proposal is $0.48 per quarter or $1.92 annually, an increase from our current $0.45 per quarter.

Cliff reviewed our 2014 guidance, but I would just further highlight that we have four solid growth segments that we anticipate will represent over 55% of our revenue in 2014. As highlighted in our guidance, we will continue to invest in 2014 for long-term growth opportunities across the entire business positioning us well for the future.

And before moving to Q&A, I wanted to briefly address the CFO transition that was also announced this morning. I've enjoyed being part of the Garmin family for the past 15 years, and I'm very excited about the future success of Garmin. It's been so rewarding to be part of building such an amazing organization since we went public in the year 2000. Yet, it's time for me to change pace personally. I look forward to helping the executive team with the CFO search process, and ensuring a smooth transition. I will also continue to be actively involved in the Investor Relations activities during the transition and will hopefully be able to see many of you in person over the course of this year.