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GRMN - Q4 2015 Garmin Ltd Earnings Call

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OVERVIEW:
Co. reported 4Q15 revenues of $781m, operating income of $146m and pro forma EPS of $0.74. Expects 2016 revenues to be approx. $2.82b and pro forma EPS to be approx. $2.25.

CORPORATE PARTICIPANTS

Teri Seck *Garmin Ltd. - Manager of IR*

Clifton Pemble *Garmin Ltd. - President and CEO*

Doug Boessen *Garmin Ltd. - CFO and Treasurer*

CONFERENCE CALL PARTICIPANTS

Simona Jankowski *Goldman Sachs - Analyst*

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Brad Erickson *Pacific Crest Securities - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Garmin Ltd.'s fourth-quarter 2015 earnings conference call.

(Operator Instructions)

I would now like to introduce your first speaker for today, Teri Seck, Manager of Investor Relations. You have the floor, ma'am.

Teri Seck - ***Garmin Ltd. - Manager of IR***

Good morning. We would like to welcome you to Garmin Ltd.'s fourth-quarter 2015 earnings call. Please note that the earnings press release and related slides are available at Garmin's Investor Relations site on the internet at www.garmin.com/stock. An archive of the webcast and related transcript will also be available on our website.

This earnings call includes projections and other forward-looking statements regarding Garmin Ltd. 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. Information concerning these risk factors is contained in our form 10-K, which will be filed with the Securities and Exchange Commission later today.

Presenting on behalf of Garmin Ltd. this morning are Cliff Pemble, President and Chief Executive Officer, and Doug Boessen, Chief Financial Officer and Treasurer. At this time I would like to turn the call over to Cliff Pemble.

Clifton Pemble - ***Garmin Ltd. - President and CEO***

Thank you, Teri, and good morning, everyone. As announced earlier today, Garmin reported fourth-quarter revenue of $781 million, representing a 3% decline year over year. While our revenue trends are impacted by the ongoing secular decline of the PND market, I'm pleased to report that the aviation, fitness, marine, and outdoor segments, as a group, grew 11% year over year and contributed 66% of total revenues. This growth and diversification of our revenue base is a direct result of the investments we have made in our business over the past few years. Gross margin was 52.9%, ahead of our expectations, but down slightly year over year, driven primarily by the competitive dynamics in our fitness segment. Operating margin declined to 18.7%, as we continued to invest in engineering and advertising. These factors, offset by a lower-than-anticipated effective tax rate, resulted in pro forma EPS of $0.74 in the quarter.

Looking briefly at our full-year performance, we reported revenue of $2.8 billion, a 2% decline year over year, driven mainly by global currency shifts that created significant revenue and margin headwinds. Despite these headwinds, the aviation, fitness, marine, and outdoor segments grew 9% on a combined basis, contributing nearly $1.8 billion in revenue for the year, or 63% of the total, and generating 75% of our operating income. Gross and operating margins of 54.6% and 19.5%, respectively, were down compared to 2014, but exceeded our expectations in a difficult global economy. Unit deliveries increased to 7% for the year, to 16.2 million.

Doug will discuss financial results in greater detail in a few minutes, but first I'll provide a few comments on each business segment. Beginning with the fitness segment, revenue for the year grew 16%, driven by growth in activity trackers. Gross and operating margins were 55% and 20%, respectively. Gross margin was impacted by the competitive dynamics in the market, while operating margin was further impacted by ongoing investments in advertising and engineering. We believe these investments are strategically important in order to maximize the long-term opportunity in the fitness market.

In 2015, we introduced Garmin Elevate wrist heart rate technology into our running and activity tracker product lines, and we made significant enhancements to Garmin Connect mobile. These developments have strengthened our position in the market, and positively impacted our results for the year. In 2016 we are targeting revenue growth of approximately 10% in the fitness segment. New product introductions play a key role in our growth assumptions.

Looking at outdoor, revenue declined 1% year over year as economic and geopolitical issues impacted sales of our core product categories. This weakness was partially offset by the strength in the outdoor wearable category. The outdoor segment continued to generate strong gross and operating margins of 61% and 33%, respectively. This represents a slight decline compared to 2014 due to product mix and additional investments in engineering and advertising to support new product launches. In 2016, we expect revenue growth of approximately 10%, which includes anticipated contributions from PulsedLight and the pending acquisition of DeLorme. We anticipate that the wearable category will continue to be strong in 2016, driven by the new fenix 3 HR with wrist heart rate. In addition we expect to benefit from new product introductions across other categories.

Turning next to aviation, we reported year-over-year revenue growth of 3%, which exceeded our expectations in the midst of an industry decline of 5% as reported by the General Aviation Manufacturers Association. Gross and operating margin remained strong at 74% and 28%, respectively. In the fourth quarter, the G3000 equipped Hondajet became the latest aircraft to receive FAA certification, bringing the total to 64 aircraft platforms certified with a Garmin integrated cockpit. In 2016, we are targeting revenue growth of approximately 5% in the aviation segment. While industry dynamics remain a factor, market share gains and new platforms provide opportunities for growth.

Looking next at the marine segment, we reported year-over-year revenue growth of 15%, driven by strong sales of new products. Gross margin improved to 55%, while operating margin was down slightly to 10%, due to litigation related costs. However, operating income grew 9% for the year, due to stronger revenue and gross margin. For 2016, we are targeting revenue growth of approximately 10% in the marine segment, driven by new product introductions. We believe our product lineup is very strong as we enter the marine season and we look forward to another year of growth in 2016.

Looking finally at the auto segment, revenues were down 15% for the full year as expected due to the ongoing decline of the PND market. Gross and operating margins were 44% and 13%, respectively, and our global market share remains very strong. During the year, our presence at Honda expanded and now includes their Pilot, Accord, Civic and CRV models. Additionally, our presence at Mercedes recently expanded and now includes their C and E class models. Looking at 2016, we expect revenue to decline approximately 15%, driven primarily by ongoing declines in the PND market. We remain focused on disciplined execution in order to bring desired innovation to the market and to maximize profitability in this segment.

I want to highlight one other matter regarding action cameras. As of 2016, we have reclassified our action camera product line from the outdoor segment into the auto segment. We believe this change will enhance the alignment of our engineering, marketing, and sales resources. Going forward, segment results will be adjusted to reflect this change.

So in summary, we see many opportunities ahead in 2016. However, the macroeconomic challenges we faced in 2015 remain part of the operating environment. With this in mind, we are projecting revenue of approximately $2.82 billion, which is flat year over year, and steady gross margin of approximately 54.5%. We are projecting operating income of approximately $510 million, with operating margins of approximately 18%. Factoring in an effective tax rate of approximately 20.5%, pro forma earnings per share is expected to be approximately $2.25, which includes a $0.05 negative impact related to acquisition. That concludes my remarks. Next, Doug will walk you through additional details of our financial results. Doug?

Doug Boessen - ***Garmin Ltd. - CFO and Treasurer***

Thanks, Cliff. Good morning, everyone. I'd like to begin by reviewing our fourth-quarter and full-year financial results, then move to comments on the balance sheet, cash flow statement and taxes. Revenue of $781 million for the fourth quarter, representing a 3% decrease year over year. Gross margin was 52.9%, a 70 basis point decrease from the prior year, driven by the increased competitive pricing in the fitness segment.

Operating income was $146 million. Operating margin was 18.7%, a decrease of 320 basis points from the prior year. This is the result of both a decline in the gross margin rate and operating expense growth of 5%, or $12 million, driven by litigation related costs, an increased spending in advertising, and research and development. The pro forma effective tax rate of 13%. Pro forma EPS was $0.74.

Looking at full-year results, we posted revenue of $2.82 billion for the year, representing a 2% decrease year over year. Gross margin was 54.6%, a 130 basis point decrease from the prior year. Operating income was $550 million, compared to $691 million in 2014. Operating margin was 19.5%, a decrease of 460 basis points from the prior year, driven by both gross margin declines and increased operating expenses. Pro forma effective tax rate increased to approximately 20% for full year 2015, compared to approximately 17% in 2014. Pro forma EPS was $2.49, a 20% decrease year over year. We'll discuss gross margin, operating expenses, effective tax rate, in more detail later.

Next, we'll look at fourth-quarter and full-year revenue by segment. During the fourth quarter, we experienced growth in four of our five segments, led by fitness, with 14% growth, and aviation with 12% growth. Collectively, these four segments were up 11%, compared to their prior-year quarter. For the full year 2015, we experienced growth in three of our five segments, led by fitness, with 16% growth, and marine, with 15% growth.

Looking at fourth-quarter revenue charts on this page, the auto segment represented 35% of our total fourth-quarter 2015 revenue compared to 42% in fourth quarter of 2014. Fitness grew to 29% of revenue in the current period compared to 25% in the prior year. As you can see from the charts to illustrate profitability mix by segment, outdoor, fitness, marine, and aviation collectively, delivered 75% of operating income in the fourth quarter of 2015 compared to 68% in the fourth quarter of 2014.

Drilling down year-over-year gross margin by segment, both aviation and marine posted gross margin rate increases due to product mix. Fitness gross margin rate was lower due to competitive pricing dynamics and product mix. Looking at full-year metrics, for the full year, the non-auto segments made up 62% total revenue, compared to 57% 2014. The similar shift occurred in operating income, with 75% of our 2015 operating income collectively coming from outdoor, fitness, marine, and aviation segments, compared to 69% 2014.

Looking next at operating expenses, as previously mentioned, fourth-quarter operating expenses increased by $12 million, or 5%. This was a 250 basis point increase as a percent of sales. Research and development increased $4 million year over year, or 90 basis points, 13.6% of sales. We continue to invest in innovation with increasing resources focused primarily on aviation, fitness, outdoor and marine, where we see long-term growth opportunities.

Our advertising expense increased $3 million over the prior-year quarter, represented 7.3% of sales, 50 basis point increase. Additional spending was primarily in the fitness segment, a near-term focus on market share growth in wearables. SG&A was up $5 million compared to the prior quarter, increasing 100 basis points percent of sales to 13.4%. Increased spending SG&A was driven primarily by litigation-related costs and IT expenses.

A few highlights on the balance sheet and cash flow statement. We ended the quarter with cash, marketable securities about $2.4 billion. Accounts receivable increase sequentially due to the holiday quarter and was down year over year to $531 million. Our inventory balance increased year over year $501 million as we grew our product offerings and continue to maintain an adequate supply of raw materials or safety stock.

During the fourth quarter of 2015, we generated free cash flow of $131 million. Also in the quarter, we paid dividends of $97 million, repurchased $23 million of Company stock, with $160 million remaining for purchase through December 2016. With our dividend, stock repurchase activity during 2015 we turned $509 million of cash to our shareholders.

As I previously mentioned, our effective tax rate decreased to 13% in the current quarter, compared to a pro forma tax rate of 19% in the fourth quarter of 2014. The lower tax rate was primarily a result of income mix by tax jurisdiction, which is positively impacted by the increase in actual full-year taxable income compared to previous projections and the resulting catch-up benefit for the first three quarters of 2015. Consistent with prior year, fourth-quarter tax rate include the full-year impact of the R&D tax credit. Our full-year pro forma effective tax rate increased from 17% 2014 to 20% 2015, primarily due to income mix by tax jurisdiction. I expect our full-year tax rate for 2016 to be approximately 20.5%.

We announced this morning that we plan to seek shareholder approval for a dividend of $2.04 per share, payable in four installments of $0.51 per share per quarter, beginning with the June 2016 calendar quarter. As Cliff mentioned, the beginning of 2016 we will recast action camera sales expenses from our outdoor segment to our auto segment. As such, we'll provide a supplemental schedule to help assist in updating your models. A link to this schedule can be found within the appendix in today's webcast. This is concludes our formal remarks. Andrew, can you please open the line for Q&A?