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Presentation

Operator

Hello, and welcome to the Garmin Ltd. Third Quarter 2023 Earnings Call. [Operator Instructions]

I will now turn the conference over to Teri Seck, Director of Investor Relations. Please go ahead.

Teri Seck

Director of Investor Relations

Good morning. We would like to welcome you to Garmin Ltd.'s Third Quarter 2023 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, segment growth rates, earnings, gross margins, operating margins, future dividends or share repurchases, market shares, product introductions, future demand for our products and plans 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 filed with the Securities and Exchange Commission.

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 Albert Pemble

President, CEO & Director

Thanks, Teri, and good morning, everyone.

As announced earlier today, Garmin delivered outstanding results in the third quarter, with strong growth in consolidated revenue, operating income and earnings. Consolidated revenue came in at \$1.28 billion, up 12% over the prior year, driven by growth in 4 of our 5 business segments.

Gross and operating margins were 57% and 21.2%, respectively, resulting in operating income of \$270 million, up 13% year-over-year. We registered GAAP EPS of \$1.34, and pro forma EPS came in at \$1.41, up 14% over the prior year. We are pleased with our third quarter results and are updating our full year 2023 guidance accordingly. We now expect revenue of approximately \$5.15 billion and pro forma EPS of \$5.25.

Before turning the call over to Doug, I'll provide highlights by segment and an outlook of what we see ahead.

Starting with the fitness segment. Revenue increased 26% to \$353 million, a new third quarter record for the segment and a continuation of the strong performance we've been experiencing all year.

Growth was [indiscernible] based across all categories, led by strong demand for wearables. Gross and operating margins were 54% and 21%, respectively, resulting in improved year-over-year operating income of \$75 million. During the quarter, we introduced the new Venu 3 smartwatch family in two sizes as well as the value packed vivoactive 5 with a bright AMOLED display. These wearables have robust new health and wellness features, including nap detection and enhanced sleep coaching.

Also, we recently announced that our ECG App is now approved for use with recently introduced products, including the Venu 3 as well as our popular, epix Pro and fenix 7 Pro series watches. This FDA cleared and

clinically validated app records heart rhythms and checks for signs of atrial fibrillation. The expansion of the ECG App gives our customers another powerful tool for managing their health. Given the strong year-to-date performance and the current trends, we now expect fitness revenue to increase approximately 20% for the year.

Moving to the outdoor segment. Revenue increased 7% to a third quarter record of \$434 million, with growth across multiple categories, led by venture watches. Gross and operating margins were 62% and 31%, respectively, resulting in operating income of \$136 million.

During the quarter, we launched the tactix 7, with a bright AMOLED display, a night vision compatible flashlight and up to 31 days of battery life. We recently announced the MARQ Carbon premium smartwatch collection, crafted from 130 layers of used carbon fiber, making these watches distinctive, strong, lightweight and ready for adventure.

We're pleased with the performance of the outdoor segment, but the path to growth has been plunging than anticipated when compared to the strong performance of 2022 and the timing of product introductions in 2023. Given the year-to-date performance, we now expect outdoor revenue to decrease approximately 5% for the year.

Looking next at the aviation segment. Revenue increased 5% to a third quarter record of \$198 million, with growth driven by OEM product categories. Gross and operating margins were strong at 75% and 25%, respectively, resulting in operating income of \$49 million.

During the quarter, we were ranked #1 in avionics product support by Aviation International News for the 20th consecutive year. Being consistently recognized for unrivaled support year after year highlights our strategic focus on taking care of customers and standing behind our products.

Also, we recently announced a long-term agreement to provide state-of-the-art G3000 integrated flight decks to BETA Technologies for its all-electric aircraft. Year-to-date, revenue from aviation has increased 11%, and we are very pleased with this result.

As a reminder, we faced significant supply chain constraints in 2022 that shifted revenue into the final quarter of the year, as we caught up on back orders. We do not expect these conditions to repeat in 2023. With this in mind, we are maintaining our 5% growth estimate for the full year, implying that fourth quarter revenue from aviation will decrease approximately 10% year-over-year.

Turning to the marine segment. Revenue decreased 7% to \$180 million, with decreases across multiple product categories, partially offset by contributions from JL Audio. As many have reported, the marine market has slowed in 2023, but we've been performing better than the market, and our third quarter performance exceeded our expectations. Gross and operating margins were 52% and 13%, respectively, resulting in operating income of \$24 million.

During the quarter, we launched the GPSMAP 9000 series in multiple sizes, including the 27-inch GPSMAP 9227 that was recognized with an innovation award at the recent International Boatbuilders' Exhibition. For the ninth consecutive year, the National Marine Electronics Association named Garmin Manufacturer of the Year, and we received 5 Product of Excellence awards. We were also recognized as the Most Innovative Marine Company by Soundings Trade Only, a leading marine trade publication.

We recently completed the acquisition of JL Audio, an iconic premium audio brand that extends our ability to offer highly integrated audio features across all of our marine product lines. Given the better-than-expected third quarter performance and the addition of JL Audio, we're updating our expectations for 2023. We now expect full year marine segment revenue to be approximately flat to the prior year. During the fourth quarter, we expect JL Audio to be approximately 15% of total marine segment sales.

Moving finally to the auto OEM segment. Revenue increased 59% to \$110 million, a third quarter record with growth primarily driven by increased shipments of domain controllers to BMW. Gross margin was 21% and the operating loss narrowed to \$14 million.

During the quarter, domain controller deliveries continue to ramp across the BMW lineup. We also experienced strong growth in infotainment categories, with contributions from Yamaha Motorsports and Honda motorcycles. Given the strong year-to-date performance, we now expect auto OEM revenue to grow approximately 40% for the year.

That concludes my remarks. Next, Doug will walk you through additional details on our financial results. Doug?

Douglas Gerard Boessen

CFO & Treasurer

Thanks, Cliff. Good morning, everyone.

I'll begin by reviewing our third quarter financial results, provide comments on the balance sheet, cash flow statement, taxes and updated guidance.

We posted revenue of \$1.278 billion for the third quarter, representing a 12% increase year-over-year. Gross margin was 57%, a 100-basis-point decrease from the prior year quarter. The decrease was primarily due to segment mix, partially due to product mix in certain segments.

Operating expense as a percentage of sales was 35.9%, a 190-basis-point decrease. Operating income was \$270 million, a 13% increase. Operating margin was 21.2%, a 20-basis-point increase. Our GAAP EPS was \$1.34. Our pro forma EPS was \$1.41, a 14% increase from the prior year.

Next, we'll look at our third quarter revenue by segment and geography. In the third quarter, we achieved record consolidated revenue and growth in 4 of our 5 segments, led by double-digit growth in both the fitness and auto OEM segments. By geography, Americas and EMEA regions achieved double digit growth of 12% and 15%, respectively, while the APAC region achieved solid growth of 8%.

Looking next at operating expenses. Third quarter operating expenses increased by \$27 million or 6%. Research and development increased \$13 million year-over-year, primarily due to engineering personnel costs. SG&A increased \$12 million compared to prior quarter, primarily to increases in personnel-related expenses, information technology costs. Advertising expense increased primarily -- approximately \$2 million, primarily due to higher co-op advertising spend.

A few highlights on the balance sheet, cash flow statement and taxes. In the quarter, with cash and marketable securities, approximately \$2.8 billion. Accounts receivable of \$721 includes the addition of JL Audio and was in line with the year-over-year increase in sales. Inventory balance increased year-over-year to \$1.4 billion to execute our strategy to optimize inventory reductions to our consumer inventory more than offsetting increases associated with our auto OEM business, with the addition of JL audio inventory.

During the third quarter of 2023, we generated free cash flow of \$312 million, a \$28 million increase from the prior year quarter, primarily due to a lower use of cash purchase of inventory. Capital expenditures for the third quarter were \$46 million. We now expect full year 2023 free cash flow to be approximately \$900 million.

During the third quarter, we paid dividends of approximately \$140 million. Also, we purchased \$9 million of company stock and approximately \$18 million remaining at quarter end share purchase program which was authorized through December of 2023. Pro forma effective tax rate was 7.2% compared to 4.3% in the prior year quarter. Year-over-year increase was primarily due to income mix by jurisdiction.

Turning next to our full year guidance. We estimate revenue of approximately \$5.150 billion compared to our previous guidance of \$5.50 billion. We expect gross margin to be approximately 56.7% compared to our previous guidance of 57.2%. The change is primarily due to the anticipated full year segment mix, the mix of increased sales of newly acquired JL Audio, which has expected gross margin lower than the marine segment average. We expect an operating margin of approximately 19.8%. Also, we expect a pro forma effective tax rate of 8.5%, which is unchanged from our previous guidance. This results in expected

pro forma earnings per share of approximately \$5.25, which includes approximately \$0.05 dilutive impact related to a newly acquired JL Audio, which is unfavorably impacted by effects of purchase accounting. This concludes our formal remarks. Sarah, can you please open the line for Q&A?

Operator

There are no further questions at this time. I will turn the call back to Teri Seck for closing remarks.

Teri Seck Director of Investor Relations

Thanks, everyone, for your time today. Doug and I will be available for callbacks throughout the day and talking to many of you. Have a wonderful day. Bye.

Operator

This concludes today's conference call. Thank you for joining. You may now disconnect.

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