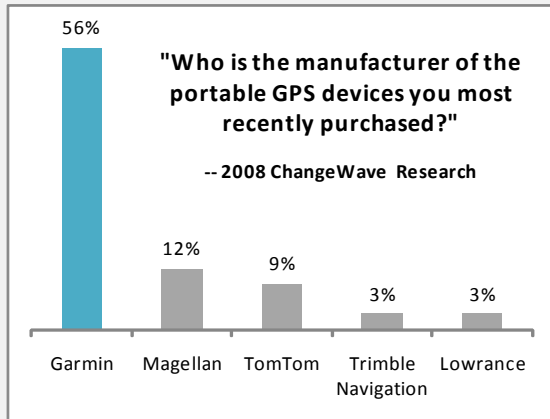


Recommendation: **BUY**

### Dominate in U.S. Consumer GPS Market



Company: Garmin Ltd.  
Ticker: NASDAQ: GRMN  
Headquarters: Olathe, Kansas

Price Target: \$ 24.00  
Current Price (4/3/09): \$ 23.10  
52 Week Range: \$ 14.40 - 56.94

	Comps	GRMN
Market Cap (M):	9,381.0	4,867.0
Inventory Turnover (ttm)	4.5	2.9
PEG Ratio (Yahoo!)	0.9	0.8
Price/Sales (2010):	0.7	1.6
Price/Earnings (2010):	7.6	9.8
Cash per Share (YE 2008):	2.33	3.37
Dividend Yield (%):	2.3	3.2

	Comps	GRMN
ROA %(ttm):	15.4	23.5
ROE %(ttm):	24.7	32.9
ROIC %(ttm):	25.0	49.6

**Comparables:** Cobra Electronics, Honeywell, Raymarine, Rockwell Collins, TomTom

We place a **BUY** on Garmin shares.

### INVESTMENT THESIS

- We believe the notion of “death of personal navigation devices (PND)” is largely overblown. While mobile phones equipped with navigation will undoubtedly eat into PND sales, it will not occur as quickly or to the magnitude expected by analysts.
- Uncertainty surrounding the nüvifone launch has unduly impacted Garmin’s stock, which is trading at the lower end its 52-week range. The nüvifone, while important to Garmin’s future success, is only one product in the company’s large and expanding product portfolio. Garmin manufactures and sells 15-20 products in all, depending on the break-down, dampening the effect of any one product on bottom line results.
- While the current market price of Garmin’s shares is near our \$24.00 price target, we believe the company’s 3.2% dividend yield provides a sufficient margin of safety. Moreover, Garmin has no debt and \$3.37 in cash per share. We expect annual cash flows to exceed \$450 million through 2011.

### COMPANY OVERVIEW

Garmin is a worldwide leader in navigation technology. It designs, manufactures and sells products that allow objects, people and animals to be tracked in real time. As of Q3 2008, Garmin captured more than 50% of the U.S. market share and about 35% of the global market share in personal navigation devices (PNDs).<sup>1</sup>

The company’s devices and software utilize the Global Positioning System (GPS), a government-operated system of orbiting satellites that permit location-based tracking on Earth.

The company is incorporated in the Cayman Islands and is headquartered in Olathe, Kan. Garmin’s products fall into four segments: automotive/mobile, aviation, marine, and outdoor/fitness. The following chart lists the major devices in each of Garmin’s four product segments.

Auto/mobile	Aviation	Marine	Fitness/outdoor
PNDs	Integrated systems	Chartplotters	Two-way radios
Traffic receivers	Panel mounts	Sounders	Watches
Mobile phones (coming)	Portable navigators	Fishfinders	Mapping handhelds

<sup>1</sup> Canalys press release, “GPS Smartphone Shipments Overtake PNDs in EMEA.” Nov. 4, 2008. [www.canalys.com](http://www.canalys.com)

## PRODUCT PORTFOLIO EVOLUTION

While Garmin's four product segments have remained the same over the years, the contribution each makes to top and bottom line results has not. As customer demands have evolved, and as Garmin has launched new products, its revenue and income mix has changed.

Segment Performance			
		FY2005	FY2008
Auto/ mobile	% of Revenue	39.2%	72.6%
	Gross Margin	44.0%	38.5%
	% of Income	33.7%	57.7%
Aviation	% of Revenue	22.3%	9.3%
	Gross Margin	66.2%	67.3%
	% of Income	26.7%	15.2%
Marine	% of Revenue	15.4%	5.9%
	Gross Margin	51.2%	54.5%
	% of Income	15.2%	8.4%
Fitness/ Outdoor	% of Revenue	23.1%	12.2%
	Gross Margin	52.7%	57.7%
	% of Income	24.4%	18.7%

The auto/mobile segment has grown in importance for Garmin, contributing nearly 73% of Garmin's revenues in 2008 and about 58% of its income. However, gross margins in this segment fell 5.5 percentage points from 2005 to 2008. That negative trend was offset by increasing margins in the other three segments.

Looking forward, we believe margins will continue to compress in the auto/mobile segment, eventually settling in the 32-35% range. Offsetting this margin compression will be increases in units sold, which will allow Garmin's bottom line to continue growing. We project a decline in sales in 2009 due to slower consumer spending, a product of the current recession, and lower unit prices.

Garmin Key Value Drivers Forecast					
	FY2007	FY2008	FY2009E	FY2010E	FY2011E
Sales	3,180.3	3,494.1	3,000.0	3,052.5	3,116.6
<i>Sales Growth (%)</i>	79.3	9.9	(14.1)	1.8	2.1
Gross Profit	1,525.7	1,587.3	1,260.0	1,282.1	1,246.6
<i>Gross Margin (%)</i>	48.0	45.4	42.0	42.0	40.0
Operating Profit	907.4	862.1	577.5	572.3	584.4
<i>Operating Margin (%)</i>	28.5	24.7	19.3	18.8	18.8
Net Income	855.0	732.8	495.7	495.8	501.1
<i>Profit Margin (%)</i>	26.9	21.0	16.5	16.2	16.1

## nüvifone LAUNCH

Garmin announced it will release the nüvifone product line in the first half of 2009.<sup>2</sup> With the nüvifone, Garmin

<sup>2</sup> Garmin press release, "Garmin-Asus nüvifone." Feb. 12, 2009. [www.garmin.com](http://www.garmin.com)

will be competing with mobile phone manufacturers, like Nokia. The company's value proposition is to seamlessly integrate navigation into the mobile phone, making it a prominent feature rather than an after-thought.<sup>3</sup>

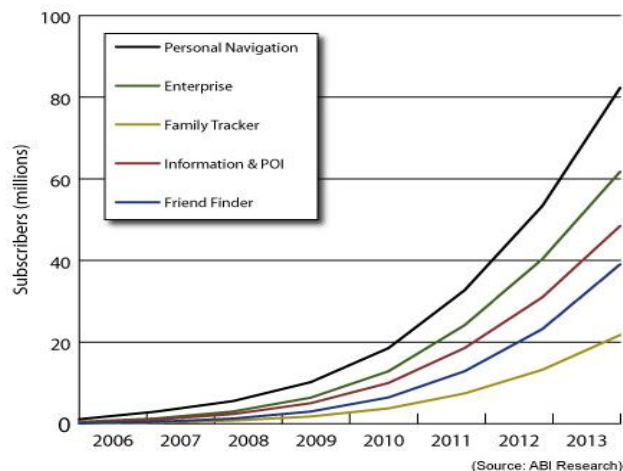
There is a concern among analysts that the nüvifone will substantially cannibalize Garmin's existing product lines.<sup>4</sup> However, the nüvifone is only one product in Garmin's growing line-up and will not, in our opinion, materially harm sales of Garmin's other products in the near term. Furthermore, although details have not been released, we believe the recently announced deal to manufacture and market the nüvifone with Asus,<sup>2</sup> spreads the risk associated with the new product launch.

## INDUSTRY ANALYSIS

Garmin competes in the information technology sector, with a specific focus on GPS equipment and software. While aviation and marine segments of the industry have been present for decades, the personal navigation market is relatively nascent, emerging in the mid-to-late 1980s.

The personal navigation industry has exploded since the early 1990s, growing from essentially zero in industry revenues. The industry is expected to top \$240 billion in revenue by 2013.<sup>5</sup>

The graph below shows that the industry is expected to continue growing in terms of subscribers through 2013.<sup>5</sup>



<sup>3</sup> According to Kevin Rauckman, Garmin CFO, during the 2008 Big XII Case Competition.

<sup>4</sup> Rob Sanderson, "Offloading Some Smartphone Costs and Upside." American Technology Research. Feb. 5, 2009.

<sup>5</sup> ABI Research, "Global Navigation Satellite Positioning Systems." April 2008.

While Garmin and TomTom are industry leaders in the U.S. and Europe, respectively, many other smaller competitors exist. This had led to intense price competition, driving down average selling prices of personal navigation devices, which we expect to continue.

## VALUATION

According to our discounted cash flow (DCF) analysis, Garmin's shares are undervalued by 4.0%. We forecasted free cash flows to be decreasing in 2009 due to the current recession and increasing competition continuing to erode operating margins. Cash flows were discounted at a relatively high 12.8% due to the fact that Garmin is entirely equity financed. We project capital expenditures to drop substantially as upgrades and expansions to its factories have largely been completed. According to Garmin management, \$60 million has been budgeted for capital expenditures in 2009.<sup>6</sup>

FREE CASH FLOWS					
	2007	2008	2009E	2010E	2011E
EBITDA	969.8	940.5	678.1	679.8	694.4
Less: Cash taxes	123.3	181.5	131.8	131.8	133.2
Less: Capex	156.8	119.6	60.0	72.0	68.0
Less: Inc. in NWC	364.6	10.4	(106.0)	12.1	14.7
Free Cash Flow	325.2	629.0	592.4	464.0	478.4

Other assumptions in our DCF valuation included an effective tax rate of 21.0% as expected by management,<sup>7</sup> much higher than the past rate of 14.0%, and a perpetual growth rate of 2.0%.

In addition to our DCF model, we created a relative valuation model, comparing Garmin's segments to key competitors. Using our comparable valuation model we derived a target price for Garmin of \$23.27.

Target Price by Segment					
	Pct. of 2010 EPS	Earnings 2010 (M)	2010 EPS Estimate	Projected 2010 P/E	Price
Auto/mobile	51%	495.8	1.20	9.0	10.80
Aviation	18%		0.42	12.0	5.08
Marine	9%		0.21	8.0	1.69
Fitness/outdoor	22%		0.52	11.0	5.69
Shares (FD)(M)	210.7			P* =	\$ 23.27

We developed our relative valuation by taking the earnings for each segment in 2010 and multiplying them by the P/E for the comparable competitor to that

<sup>6</sup> Garmin, 2008 10-K, pg. 49.

<sup>7</sup> Garmin, 2008 10-K, pg. 42.

segment. Comparables were chosen based on their product mix, company (segment) size, and growth rates.

Garmin's Competitors by Segment			
Auto/mobile	Aviation	Marine	Fitness/
TomTom	Honeywell	Raymarine	Cobra
	Rockwell Collins		TomTom

We calculated the forward P/E for each comparable and adjusted it based on the comparable operating margin compared to Garmin's segments. In all four segments we adjusted the P/E ratio up a point or two because Garmin had superior margins relative to its competition.

	Garmin	Average	Cobra	Honeywell	Rockwell Collins	TomTom
Market cap (\$M)	4,867	9,381	0	22,470	5,230	443
ROA %(ttm)	23.5	15.4	(0.9)	9.3	14.6	22.3
ROE %(ttm)	32.9	32.9	(0.0)	34.0	45.1	19.7
ROIC %(ttm)	49.6	25.0	(0.0)	29.2	34.0	11.7
Gross Margin %(ttm)	44.5	35.2	35.0	23.4	38.4	43.9
Oper. Margin %(ttm)	24.7	14.5	3.0	9.7	20.3	24.8
P/E (2010)	9.8	7.6	N/A	9.6	8.5	4.7

There are many factors that affect a company's forward P/E ratio, so we did not place much emphasis on the comparable valuation. We believe DCF analysis is the superior method in the case of Garmin, although our price targets were nearly the same using both models.

Finally, we conducted a sensitivity analysis on key value drivers in our DCF model, showing associated changes to our target price.

Sensitivity Analysis			
Sales			
	Change From Forecast / Year		
	-10%	5%	10%
Price Target (\$)	22.52	25.01	25.84
Operating Margin			
	Change From Forecast / Year		
	-200 bps	100 bps	200 bps
Price Target (\$)	22.10	25.30	26.37

## CONCLUSION

While analysts and investor seem fixated on the uncertainty surrounding Garmin's nüvifone launch, we believe the current share price represents a solid buying opportunity. With a strong balance sheet – no debt and more than \$700 million in cash – and high free cash flows, we expect Garmin to continue paying its dividend. The 3.2% dividend yield provides a solid return in addition to potential capital gains on Garmin shares.