Garmin Analysis

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Garmin is at a crossroads in the navigation market. There are new introductions to personal navigation devices (PND) through smart phones such as Apple’s Iphone and RIM’s Blackberry. This has eroded the profitable automotive segment. This case study will focus on Garmin becoming a niche operator in three major lines that it currently operates. These are marine, aviation and fitness/outdoor segments. The assumptions for this case study are automobile sales will deteriorate and be offset by minor success in the mobile segment and automobile sales will experience no growth, in three years Garmin will divest of mobile and automobile operations and receive $1.5 billion, Garmin will have dominant market share in aviation, marine and outdoor/fitness equal to 25% market share. These markets have annual sales of $4 billion and are growing at 10% per year. Garmin is the brand leader and preferred choice of customers and market share will grow at significant rates. This scenario will be called the niche operations. The automobile and mobile operations will be called the legacy operations.

**Current Assets**

Current assets are key to any organization. They represent the liquid portion of assets that are available to meet current liabilities and emergency needs. Garmin has a strong liquidity position and it will be bolstered with the sale of the automobile/mobile operations for $1.5 billion. Garmin’s cash per share stands at $5.45 per share in 2009 with no change the cash per share would be $12.95 per share in 2013. Cash must be deployed in capital expenditures to increase revenue or returned to shareholders via dividends or share repurchases. Inventories will grow as Garmin loses market share in the mobile and automobile is run off and the other niche lines are ramped up. Consumers will be less interested in the legacy lines and interest will grow in the niche lines leaving old inventory and increasing new inventories. Year 3 will see a tremendous decrease in inventory as the legacy unit is sold and the growth niche market is ramped up. The Cash Conversion Cycle (CCC) is a way to analyze the current assets and liabilities of a company. CCC is 3 measures in one. It is a measure of the inventory conversion period + average collection period – payables deferral period. The change to the niche lines will probably leave the CCC about the same. The inventory turnover will increase but should be offset by collections will slow down as the smaller firms are often slower to pay and the payables will probably stay the same.

**Long Term Assets**

Garmin’s long term asset will change significantly. The legacy business assets will be written down as they will not be reinvested in as heavily and new technology for the niche operations will grow and since they are newer the depreciation will not be as significant leaving larger amounts of new long term assets. Niche assets will have a higher return on invested capital (ROIC) as the markets for the niche are growing at 10% per year as opposed to the current declining rates on the legacy business. Hurdle rates will be as high since niche products have good growth rates. A growth business allows the company to invest in capital expenditures that have lower rates of return since they will increase sales and profit margins this is known as operating leverage.

**Short Term Liabilities**

Garmin has $3.41 of short term liabilities per share at the end of 2009. This figure has grown since 2004. Cash per share has offset this but a growing concern has been the short term debt. Accounts payable will increase as retailers face volatile cash flows and often pay late. This is a risk of taking on a niche strategy since many of the operators will be smaller outlets and tend not to pay as quickly as larger established companies.

**Long Term Liabilities**

Garmin does not have any long term debt. Management should consider long term debt as the will not be faced principal payments on a yearly basis. The niche strategy has growth rates of 10% and they will slow. Long term debt allows Garmin to delay principal payments and take advantage of low interest rates. Taking on long term debt is not as friendly to shareholders as it limits the free cash flow available for dividends and stock repurchases that Garmin has been known for.

**Shareholder’s Equity**

Garmin has about 194 million shares outstanding. The current price is about $27 giving it a market capitalization of about $5.2 billion (Bloomberg, n.d.). The $1.5 billion dollar cash from the legacy business could boost share repurchases and reduce outstanding shares by up to 1/3 and increasing prices by 1/3 or $9. The company will increase its clarity to shareholders about the direction of the company as many have wondered how Garmin will succeed going forward. Dividends have been growing with Garmin. Garmin needs to adopt a consistent dividend policy to be able to control its cash needs and to determine the weighted average cost of capital (Brigham and Erhardt, 2010, p. 362).

**Income Statement**

Garmin has grown its top line sales most years but has seen a decline in 2009 and 2010 looks to be slowing as well. The niche segment will decrease sales from about $2.9 Billion to about $1.2 billion in the third year after the sale of the legacy business. Top line growth will continue to increase with a growing market and increasing market share. Gross and operating margins will increase with 10% market growth and higher margins on the niche lines.

**Cash Flow**

Cash flow from operations for Garmin is a key metric. Free cash flow per share stands at a healthy $4.43. The decrease in sales is going to decrease that number and the growth rates/margin expansion will offset that by year four to six. Garmin needs to make sure inventories and expenses are monitored carefully going forward. Garmin’s cash flow from financing activities has been driven by stock repurchases and dividends. Garmin needs to change to use cash to make capital expenditures such as research and development to continue to grow the niche lines not on share repurchases and large increases in dividends.

**Risks**

Risk management is key to Garmin’s future. They are going to have to manage risks accordingly. Garmin is going to be a market leader in the niche markets and as these markets mature Garmin will have to stay ahead of the curve. Garmin’s history is to not be flexible and change course to meet demand (Araoz, 2007. p. 75). This psychological bias will be the hard to break.

Garmin has no long term debt and faces business risk (Brigham and Erhardt, 2010, pp. 603- 604). This is the risk inherent to operations and that there is no buffer declining sales or capital requirements that must be met with equity not debt.

Currency risk from international sales of the niche products is a risk. Garmin must leartn how to hedge currency risk with a consistent firm policy. This will negate any questions as to corporate policy on how to hedge the risks from overseas operations.

**Corporate Governance**

The corporate governance of Garmin will become easier to manage as they will have to have expertise in the three lines of aviation, marine and personal /outdoor. The board does not have the depth of experience in niche areas. Gene Betts is from the landline telecom industry and Thomas Poberezny is from the aviation industry (Garmin, n.d.). The board needs to have experience from the marine industry, personal fitness industry and the outdoor industry. Gene Betts would need to be removed as he has limited experience and replaced with experienced industry leaders.

**Capital Projects: Net Present Value (NPV) and Internal Rate of Return (IRR)**

Garmin to maintain its competitive edge in the niche lines will require additional capital expenditures. The analysis of these capital projects will require the use of both NPV and IRR. The best practice is to adopt a hurdle rate for projects. The hurdle rate needs to be above the weighted average cost of capital (WACC). The IRR of the project needs to be above the hurdle rate. The NPV of the project should be worth taking on as a project for Garmin. The IRR could be very high but the NPV also needs to be such that it will make a difference for the company (Brigham and Erhardt, 2010, pp. 387-389). If Garmin has two similar projects with similar NPV and IRR they must consider the after tax cash flows from each project to determine the optimal project.

**Return on Invested Capital (ROIC) and Return on Equity (ROE)**

Garmin has the same ROIC and ROE due to the fact that they do not have any long term debt. In 2009, the ROE was 24.8% and is declining from previous years. The niche product with high growth rates will increase the ROE by about 10% per year going forward. A way to increase the ROE is to introduce some long term debt to the balance sheet. This will allow the debt to use operating and financial leverage (Brigham and Erhardt. 2010, pp.604-605). The ROIC should be greater than the WACC so Garmin can be adding value to the shareholders going forward (Brigham and Ehrhardt, 2010, p. 89).

**Social Responsibility**

Garmin has a responsibility to all stakeholders. Stakeholders include both employees, shareholders and varied outside interests. Garmin needs to spend time considering how to best maximize shareholder value to meet this social responsibility. Garmin by moving to a niche model will maximize shareholder value with the marine, aviation and personal/outdoor lines (Brigham and Erhardt, 2010, pp. 9-11).

**Cost of Capital (COC)**

COC for Garmin is expensive at an 8.3% dividend yield on the stock that is at least 800 basis points above the three month T-Bill (Bloomberg, n.d.). Garmin has no long term debt. Garmin needs to consider how to lower its cost of capital quickly. The earnings per share (EPS) are $1.00 for the quarter and the dividend is $1.50 so they are not earning their dividends (Bloomberg, n.d.). Garmin could possibly lower the COC with issuance of debt with a fixed coupon in this low interest rate environment. The weighted average cost of capital (WACC) is only the cost of short term debt and the equity if Garmin could issue debt at lower rates than the equity it could lower the WACC.

**Conclusion**

Garmin has the opportunity to change the business model and take advantage of the growth in the marine, aviation and personal/outdoor navigation devices. The automotive market is changing and sales are plummeting. People are supplementing on board navigation with their smartphone based navigation devices.

The niche market is expected to grow at 10% per year with a $4 billion market opportunity. Garmin is a leader in this market and have a 25% and growing market share. This growing market and market share has responsibilities. Garmin needs to have a disciplined approach to the cash and the projects it funds.

The projects need to be evaluated with the correct hurdle rate, IRR and NPV to increase top line sales and bottom line profits. The CCC components need to be monitored carefully since there will be new inventory and receivables. As new sales outlets are created there will be foreign sales and new currencies that need to be hedged carefully. Garmin will have plenty of liquidity to make new research and development opportunities.

Garmin has been funded exclusively by equity and should consider long term debt as part of its capital structure to lower its WACC. This will provide operating leverage and potentially increase Garmin’s ROE. Garmin’s equity has been a strong dividend payer and the board should reconsider how much it pays out as a dividend and create a consistent dividend policy. Garmins move to the niche operator requires expertise from outside directors with experience in marine and personal/outdoor lines. They have an aviation expert in Thomas Poberezny.

Garmin is at a crossroads. The company is facing a declining market in autos and it not a competitor in the smartphone market. It must change operating lines and disciplines or be sidelined by the market. A clearly articulated business model will yield greater returns for the company, shareholders and stakeholders. Garmin’s niche lines can make that change but the company management must make changes as well to be a disciplined operator of these niche lines.

**References**

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