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MCFT - Q4 2015 MCBC Holdings Inc Earnings Call

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Tim Conder *Wells Fargo Securities - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the MasterCraft FY15 fourth-quarter earnings conference call.

(Operator Instructions)

As a reminder, this call is being recorded. I would now like to introduce your host for today's conference, Chief Financial Officer, Tim Oxley. Please go ahead, sir.

Tim Oxley - MCBC Holdings, Inc. - CFO

Thank you, operator, and welcome, everyone. Today's call is being webcast live, and will also be archived on our website for future listening. Joining me on today's call are Terry McNew, MasterCraft's President and Chief Executive Officer; and Shane Chittum, MasterCraft's Chief Operating Officer. Our agenda includes a strategic overview by Terry, followed by my analysis of the financials. Then Terry will outline our strategies for growth, and expectations for FY16 prior to the Q&A session.

Before we begin, we'd like to remind participants that the information contained in this call is current only as of today, September 17, 2015. The Company assumes no obligation to update any statements, including forward-looking statements. Statements that are not historical facts are forward-looking statements, and subject to the Safe Harbor disclaimer in today's press release. Additionally, on this conference call, we will discuss non-GAAP measures that include or exclude special or non-recurring items. For each non-GAAP measure we also provide the most directly-comparable GAAP measure. Our FY15 fourth-quarter earnings release includes a reconciliation of these non-GAAP measures to our GAAP results for the fourth quarter and full year.

With that, I'd like to turn the call over to Terry.

Terry McNew - MCBC Holdings, Inc. - President & CEO

Thanks, Tim. I'd like to thank everyone for joining us today on our first earnings conference call as a public company. As you saw from today's press release, MasterCraft reported a strong fourth quarter and fiscal year, highlighting the benefits of the culture of operational excellence that we have worked hard to build over the last several years. For those of you who may be new to our story, MasterCraft is known worldwide for serving the high end of the performance sport boat market. In the last two years, we've gone beyond that sector by introducing the entry-level NXT series. That's been a key factor in our improving results, as you'll see.



For the quarter, sales rose more than 6%. Importantly, our fourth-quarter results were at the high end of the guidance provided in our S-1 filing in July. As expected, unit volumes and operating margins for the quarter were adversely affected by the transition of Hydra-Sports production out of our facility. However, we still met our internal targets against a very solid prior-year period. Our mounting growth translated into strong gains in margins and cash flow and we saw significant full-year increases in unit volume, net sales, gross margin, and adjusted EBITDA, with net sales up nearly 21% for FY15. Now that the Hydra-Sports transition is fully behind us, we are well positioned for further growth, and a continuation of this positive operating momentum.

From a macroeconomic perspective, higher consumer confidence in the United States is driving increased demand for boats, particularly performance sport boats. This, combined with a robust market acceptance of our new product launches, is fueling our top line results. On the new product front, we continue our focus on innovation by launching three all-new models in 2015, including the groundbreaking new X23, and the latest in our NXT line, the NXT22, which began production in the fourth quarter. Combined with the growth of our 2014 launches, including the all-new NXT20 and the market success of our patented Gen 2 Surf System, we enter FY16 with the deepest product line-up in our history. Further, we have an exciting pipeline of launches ahead, including the recently-announced X26.

Looking outside the United States, like any global company, we are facing headwinds due to economic conditions and foreign currency exchange rate pressures, especially in Canada. These are partially offsetting US results, but we're pleased with our strong retail performance in the fourth quarter. We finished the year with our dealer inventory pipeline in good shape. Despite the headwinds, we are poised to continue to capture additional market share and deliver growth, primarily due to the exceptional product line-up I just detailed.

I'd now like to provide more detail about the new boats we unveiled during the year. As I said, we launched three new models in FY15 -- the X20, the X23 and NXT22, all of which were well-received by the marketplace. The NXT22 addresses the highest-volume foot segment within the entry-level portion of the performance sport boat category. The X23 targets the highest-volume portion of the category's core segment, and the X20 strengthens our position in the all-important 20-foot portion of the core market. In addition to these launches, we introduced a number of high-value new features during the model year. Just recently we unveiled the new X26, the latest addition to our innovative 2016 boat line, that delivers a category-defining balance of luxury, power and playfulness. The X26 is handcrafted in our US-based manufacturing facility, here in Vonore, Tennessee. It delivers an elevated experience on the water through high-end refined features and upscale amenities, coupled with MasterCraft's legendary tow sports performance. In FY16, we plan to maintain the cadence of three relevant, innovative, new product launches annually, focusing on a robust value-added value engineering program, and operational excellence, to drive sustained margin improvement.

Outside of product launches, we achieved several other noteworthy milestones in FY15. Most notably, as you know, we took the Company public. In July, we closed our IPO, offering more than 6 million shares at \$15 a share. We've used the proceeds to pay down our debt, and I'm very pleased to report that the Company is now debt-free. On the operational excellence front, we continued to demonstrate working capital efficiency, especially with inventory dollars. Our commitment to operational excellence and innovation continued to drive ongoing margin improvement. Teamed with our strong, diverse product portfolio, MasterCraft is positioned well for continued growth. Now, I'd like to turn the call back over to Tim to go over our financials.

Tim Oxley - MCBC Holdings, Inc. - CFO

Thanks, Terry. From a top line perspective, we ended the fiscal fourth quarter with net sales of \$54.9 million, up 6.4% from the prior-year quarter. The increase was primarily due to a rising unit volume but was partially offset by a decrease in Hydra-Sports unit volume. As you'll recall, our manufacturing contract with Hydra-Sports ended in FY15. Additionally, we also experienced a planned decrease in production days, stemming from the Hydra-Sports transition. Net sales per unit grew by 3.5% in the fourth quarter, resulting from increased option uptake across all of our models. A more favorable mix of higher-priced units in our core models was offset by the continued ramp and sales of our lower-priced NXT20 product, which launched late in FY14. It's important to note that while the NXT20 dilutes net sales per unit, gross margins are comparable to our other models. We posted gross profit of \$12.8 million in the fourth quarter, a 4% gain from the same period last year.

Gross margins were 23.3%, down less than 1 percentage point, compared to the same period last year, due to the planned impact of the Hydra-Sports transition, which went better than anticipated. Gross margins for the full year increased a full 270 basis points from the prior year. On the expense front, selling and marketing expenses were flat in the fourth quarter. General and administrative expenses increased to \$3.8 million from \$2.6

million from the same period last year. The rise stemmed from costs associated with the Company's initial public offering, and a non-recurring settlement charge recognized during the quarter.

Operating expenses were 11% of net sales during the quarter, up from 9.4% in the same period last year. Excluding IPO costs, and the non-recurring charge, operating expenses were 9% of sales during the quarter. We ended the fourth quarter with GAAP net income of \$2.5 million compared to \$16.8 million for the three months ended June 30, 2014. The decrease is primarily due to the reversal of a valuation allowance for deferred tax assets during the three months ended June 30, 2014, as well as higher operating expenses from the initial public offering cost, and non-recurring settlement charge. These impacts were partially offset by the contribution from higher net sales. FY15 fourth-quarter adjusted EBITDA was \$8 million, up 6.6% from \$7.5 million, for the year-earlier quarter. And fourth-quarter pro forma adjusted net income increased 8.5% to \$3.9 million or \$0.20 per share on a pro forma diluted weighted average share count of 18.9 million shares. We've included a reconciliation of net income to adjusted EBITDA, and pro forma adjusted net income in today's press release.

In the interests of time, I won't discuss the details of our FY15 results this afternoon, but I will echo Terry's comments, and reiterate that we had a very strong year from a unit volume, net sales, gross margin, and adjusted EBITDA perspective. I will be happy to answer any fiscal year questions during the Q&A. I'll now turn it back over to Terry for our strategy and outlook.

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Thanks, Tim. As I said earlier, we are very pleased with our fourth-quarter and FY15 performance. Looking ahead, we have good reasons to be optimistic about the future. As an organization, we're intently focused on four key initiatives to drive growth in 2016: Number one, we'll continue to develop new and innovative products in core markets. Two, further penetrate the entry-level segment of the performance sport boat category. Three, drive margin expansion through continuous operational improvement, and finally, we'll further strengthen our dealer network. We believe that the execution of these initiatives will set us up well for strong organic growth and expanded profit margins in FY16.

In terms of expectations for the coming fiscal year ending June 30, 2016, we expect sales and unit volume growth, excluding Hydra-Sports, in the high single digits to low double-digit range, gross margins and adjusted EBITDA to notably increase, and higher net sales and operating efficiency gains will offset the new costs associated with being a public company. Additionally, we anticipate adjusted net income will grow in line with adjusted EBITDA. We do want to note that during Q1 of FY16, GAAP net income will be impacted by approximately \$3.5 million of expense related to changes in the fair value of common stock warrants and stock compensation expenses of approximately \$13.3 million will be recognized during the July through January time frame. This is primarily related to restricted stock and options granted prior to, and associated with the IPO. We entered the new fiscal year with solid strategies, and plans underway to meet our objectives.

We thank you for your confidence in MasterCraft, and our team is working hard every day to deliver good performance to enhance value for our shareholders. At this time, I'd like to turn it over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Joe Hovorka, Raymond James.

Joe Hovorka - *Raymond James - Analyst*

One, can you talk a little bit about what your retail sales look like in FY15 relative to your wholesale shipments?



Tim Oxley - *MCBC Holdings, Inc. - CFO*

Retail sales were up double digits in 2015, and our pipeline ended up in very good shape.

Joe Hovorka - *Raymond James - Analyst*

So was your pipeline down in units, flat in units?

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Our pipeline, Joe, this is Terry, was flat year-over-year, was very healthy as we exited 2015. Even though our wholesale volume was up and our retail volume was up in the low double digits, we're very pleased with where our pipeline ended the year.

Joe Hovorka - *Raymond James - Analyst*

Okay. As you look at the guide for revenue going forward, your high single, low double digits, can you talk a little bit about the US versus international and Canada, how you're looking at those three pieces? I'm assuming US is growing faster than that? Canada and international are a drag on those numbers?

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

That's correct. US, we saw an increase in US participation in 2015. We expect that to continue in 2016. We're all familiar with what's going on in Europe, Australia and now in Canada, since the beginning of the calendar year. So we factored that into our 2016 guidance.

Joe Hovorka - *Raymond James - Analyst*

Can you remind me what Canada represents as a percent of revenue now? In 2015?

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Canada had always been in the mid-to-upper teens in percent of contribution from units for us. It will probably go down to the lower end of that range.

Joe Hovorka - *Raymond James - Analyst*

Okay. That's all I had for now. Thanks.

Operator

Craig Kennison, Robert Baird.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

Following up on the Canada question, can you characterize demand trends in Canada, and also markets in the US like Texas, that are dependent on oil and other similar commodities?



Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Sure. Canada, of course, started to experience a fall in Canadian dollar earlier in the year. That continues as we're all aware. Then that was exacerbated a bit with the drop in oil prices, which hurts Alberta in particular. So we've seen those volumes come down a bit. As I mentioned to Joe, we factored that into our 2016 guidance.

What's interesting is, the US is still strong, even Texas, I think we could probably point to two things there. The diversification in the market, but also Texas, we all know has been dry for a long time. They started getting rain back in the early summer, and we really started seeing that market come on well. So we're very happy really with all regions in the United States, even California without the rain. There's still a good deal of demand there, but Texas has done extremely well with the water, even the upper Midwest that had a lot of rain early in the boating season, early summer, that started to subside by early to mid-June, and that picked up like normal. So we are very, very happy with every region in the United States.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

Thank you. Then there's about two weeks left in the current quarter. What can you tell us about retail trends quarter to date? And in conjunction with that, maybe address how your dealers have reacted to the launch of some of your [new boats]?

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Sure. Absolutely. We're seeing retail pretty much in line with historic retail, within the range for the first quarter of 2016. Nothing abnormal there at all, Craig. Actually our launches now, with the release of the X26, our entire portfolio has been retooled in the last four years. And so the dealers are very, very happy and excited with all the product launches recently, in the last few years. And our portfolio contributes very, very helpfully in terms of all of our models, 12 models in our portfolio contribute very, very well to us. We're not a brand that relies on one or two models.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

And then with respect to your dealer network, where did you end the year with respect to the number of dealers? And how might have that have changed since the end of that quarter?

Terry McNew - *MCBC Holdings, Inc. - President & CEO*

I don't have the number off the top of my head, Craig, but as we have shared with you in the past, our number of dealers doesn't change dramatically from year to year. We tend to have a philosophy where we try to give our dealers as large a territory as possible, where they can still effectively sell and service, and many of our top dealers, for example, carry multiple markets for us. So Tim likes to often characterize it as, we are pretty steady on our number of dealers, but we might see some consolidation amongst some of those dealers carrying multiple areas for us.

Tim Oxley - *MCBC Holdings, Inc. - CFO*

I would add, this is Tim. I would add that very little change from the numbers that were reported in March. I don't have those in front of me, but very little change.

Craig Kennison - *Robert W. Baird & Co. - Analyst*

Okay. Thank you.

Operator

Tim Conder, Wells Fargo Securities.

Tim Conder - Wells Fargo Securities - Analyst

Gentlemen, could you maybe characterize again your market share within the two segments of the industry, the entry-level and the premium? Clearly, NXT appears to be driving market share gains on the entry level. But just any more color on that, and then in the premium category? Just some clarification, gross margin ex-Hydra, if you could give us that number? And then, Tim, a little color on the nonrecurring settlement charge that you outlined there in the quarter?

Terry McNew - MCBC Holdings, Inc. - President & CEO

Tim, thanks for joining. We really appreciate it. This is Terry. I'll address the question of our core and NXT. I'd just like to emphasize to everybody that we are not two brands. Our NXT models, both the NXT20 and NXT22, are just extensions to our MasterCraft portfolio. So they are new products, each of those, as I said earlier the NXT20 launched in the fourth quarter of model year 2014, and the NXT22 just launched this past, at the fourth quarter of 2015.

So we're very pleased with the way that the NXTs have been accepted by the market. We're very pleased, the June SSI market share data was just released to us earlier this week. And we're very pleased to announce that our market share on a rolling 12, through June, went up another one point, year-over-year. So we are in the number two position within the performance sport boat category, but as a brand we were within 6/10 points from being the leading brand in market share for US, according to the SSI.

So we're real pleased with the way the NXT has contributed. We expected that to be a bigger portion of the sales increase, as expected. Those models are additive to our portfolio. As far as the gross margin, I would like to turn that over to Shane Chittum.

Tim Conder - Wells Fargo Securities - Analyst

Terry, can you break down though, clearly, you said part of the strategy is you haven't been in the entry level and to grow the entry level, which is a very, very, very wise portion there, and seems very logical, but can you give any breakdown color between that entry-level? Granted, NXT is still MasterCraft, but that color and then the premium category?

Terry McNew - MCBC Holdings, Inc. - President & CEO

It all depends on how we define premium. Some of the brands that we might define differently than you do, but we're very pleased. We think our core product, that of NXT, has kept pace with the category for growth year over year. And we believe we are in the high single-digit market share now, with the NXTs. That will be rolling 12 through June year over year. So as we started to penetrate that entry level again, Tim, this can differ depending on what brands you put in there to create a denominator, but we think we're well into the high single digits as far as market share for that entry-level portion of the performance sport boat category.

Tim Conder - Wells Fargo Securities - Analyst

Great. That helps. Thank you.

Tim Oxley - *MCBC Holdings, Inc. - CFO*

This is Tim. I want to mention something in regard to margin before asking Shane to give us some color on the drivers. We're expecting the margin growth that Terry mentioned, notable margin increase, north of 200 basis points. So I wanted to mention that for you guys for modeling. Shane, why don't you give them color on the drivers in that margin expansion?

Shane Chittum - *MCBC Holdings, Inc. - COO*

This is Shane. As you alluded to, certainly with the exit of the Hydra-Sports business, we were able to optimize our manufacturing cost structure, and increase our capacity. It's a unique driver to our gross margin growth this year. But similar to other years, we also are experiencing operating leverage in connection with gross margin. We continue to leverage our product and process very well and as we replace new models and bring out new options and features in connection with the model year, we do that at a higher margin rate. And I think most importantly, our continuous improvement process, backed up by all of our value-added [value-mirroring] efforts continues to drive manufacturing cost reductions. So all those things stacked up are contributing to our gross margin change from 2015 to 2016.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. But the gross margin ex-Hydra in Q4 specifically?

Tim Oxley - *MCBC Holdings, Inc. - CFO*

We do not have, we don't break out, this is Tim, we don't break out the gross margin between MasterCraft and Hydra. As you might recall, we subtract the variable contribution of Hydra to arrive at our adjusted EBITDA. So I think it's fair to take a look at the margin on a consolidated basis. And then the margin increase I mentioned should be added on to consolidated margin for the year.

Tim Conder - *Wells Fargo Securities - Analyst*

So the 200 is on an as-reported basis is what you're saying?

Tim Oxley - *MCBC Holdings, Inc. - CFO*

Correct.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. And then the nonrecurring, the 539, just a little color on that?

Tim Oxley - *MCBC Holdings, Inc. - CFO*

Sure. That is associated with our parting ways with one of our dealers, and a non-recurring charge associated with that.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. Then obviously there's talk about litigation out there. What have you factored in for next year, and into your expectations as far as litigation expense, absolute terms? And what do you see, timeline, anything you can say? I know there's a lot still up in the air, and there's only so much you can say, but any color you feel comfortable or what you can give?



Terry McNew - *MCBC Holdings, Inc. - President & CEO*

Sure, Tim. This is Terry. As you mentioned, this is pending litigation. We are limited in what we can say about the lawsuit and our strategy for defending it, but if MasterCraft's motion for summary judgment is not granted, we expect our legal expenses for the year and really on an annual basis to be somewhere between \$1 million and \$1.5 million annually. Similar cases like this may have a duration of between two to three years.

Tim Oxley - *MCBC Holdings, Inc. - CFO*

And this is Tim. I'd like to add, we have baked that into our guidance, as well.

Tim Conder - *Wells Fargo Securities - Analyst*

Okay. Okay. Thank you, gentlemen.

Operator

(Operator Instructions)

Mike Swartz, SunTrust.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Just wanted to touch on just commentary around NXT and MasterCraft. Understanding that you look at it as one brand, but could you give us a sense in the quarter, how much of that NXT product, or how much of your mix was NXT, and maybe how to think about that in 2016? Because there is such an ASP differential between the two?

Tim Oxley - *MCBC Holdings, Inc. - CFO*

Mike, the ASP is different. I'd like to remind everybody the gross margins are not dilutive with our NXTs. That is specifically designed, we're able to execute to that. As you know, in model year 2015, the NXT20 really enjoyed a full year. The NXT22 was just released in the fourth quarter 2015. So we like to characterize it as that first year in 2015 was, as I mentioned, primarily the NXT20. It's accounted for about 15% of our wholesale volume.

Mike Swartz - *SunTrust Robinson Humphrey - Analyst*

Okay. Any way to think about that for 2016?

Tim Oxley - *MCBC Holdings, Inc. - CFO*

With the addition of the NXT22, again the NXT22 targets the highest volume foot category within the entry-level portion of the performance sport boat category, we would expect those two models combined may make up between 20% and 25% of our wholesale volume.



Mike Swartz - SunTrust Robinson Humphrey - Analyst

Wonderful. That's great color. Just on how to think about gross margin and EBITDA, I understand the 200 basis points improvement for 2016, but maybe give us a better view or a little granularity on how you expect that to trend throughout the year? Should we look at that being more of a second half, or that growth being more of a second-half phenomenon?

Shane Chittum - MCBC Holdings, Inc. - COO

Mike, this is Shane. I think you'll see that if you look at it from a first half to second half, I think it will be sustained between both halves. We will -- we are experiencing a good quarter so far, and we expect that to continue.

Mike Swartz - SunTrust Robinson Humphrey - Analyst

Okay. Thanks a lot. Final housekeeping, share count for FY16? What should we be modeling in?

Tim Oxley - MCBC Holdings, Inc. - CFO

18.9 million on a fully diluted basis is what I would model.

Mike Swartz - SunTrust Robinson Humphrey - Analyst

Okay. Thank you.

Operator

Thank you. I'm showing no further questions at this time. I would now like to turn the call back Chief Executive Officer, Terry McNew, for any further remarks.

Terry McNew - MCBC Holdings, Inc. - President & CEO

Thank you, operator. Once again, thank you for joining us on our first earnings conference call. We had a strong FY15, and we believe that we are positioned well for the future. We look forward to updating you on our progress and first-quarter results in November. Thank you.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.



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