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MCFT - MCBC Holdings, Inc., Nautic Star, Llc - M&A Call

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CORPORATE PARTICIPANTS

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Timothy Andrew Conder *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the MasterCraft, NauticStar Acquisition Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to hand the floor over to Tim Oxley, Chief Financial Officer. Please go ahead, sir.

Timothy M. Oxley - *MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary*

Thank you, operator. Good morning, everyone, and thank you for joining us. Today's call is being webcast live and also will be archived on our website for future listening. Joining me on today's call is Terry McNew, MasterCraft's President and Chief Executive Officer.

This morning, we announced that we have acquired NauticStar Boats, LLC, a leading manufacturer and distributor of 18- to 28-foot high-quality bay boats, deck boats and offshore center console boats. We will be discussing this in more detail, and then opening up the call for questions.

Before we begin, we'd like to remind participants that the information contained in this call is current only as of today, October 2, 2017. 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. During this call, we will not be discussing questions regarding our first quarter sales and our earnings as our quarter has not -- has just been completed. We plan to discuss those results on our regularly scheduled earnings call in November.

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

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

Thanks, Tim. I'd like to thank everyone for joining us today. As you saw from today's press release, we are very excited to welcome NauticStar to the MasterCraft family.

NauticStar is a well-respected, expertly built and uniquely positioned brand. The company's outboard bay, deck and offshore center console boats provide us with additional product diversity. They also provide MasterCraft the presence in saltwater fishing as well as outboard propulsion, 2 of the fastest-growing segments in the broader boating industry. The deal unites 2 leading and complementary boating brands as NauticStar brings 15 years of boat manufacturing experience, including a 200,000 square foot manufacturing facility. The company has a reputation for reliability, quality and consistency with a loyal network of dealers and customers, including professional and sport fishermen and recreational pleasure boating enthusiasts.



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NauticStar currently sells its boats in the United States through an established network of 70 dealers. NauticStar's year-over-year unit growth is among the strongest in the 18- to 28-foot category and demand domestically currently exceeds supply. We look forward to leveraging our industry-leading strengths and operational excellence and financial management to further improve NauticStar's output, quality and margin as we continue the rapid growth. Having just signed and closed on the deal today, we are still working through our integration plans, which we'll plan to discuss in more detail on our first quarter call in November.

As a combined organization, we have the resources and experience to greatly expand NauticStar's distribution both domestically and internationally after satisfying the demand from the existing dealer network. We look forward to working together to deliver profitable and sustainable market share growth and driving efficiency in every area of our business. This combined commitment to operational excellence and innovation, teamed with our strong, diverse product portfolio, position MasterCraft well for fiscal 2018 and beyond.

Now I'd like to turn the call back over to Tim to go over our financial details of the transaction.

Timothy M. Oxley - MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary

Thanks, Terry. As you saw on the press release, we acquired all outstanding membership interest in NauticStar, LLC for \$79.8 million. We'll finance the transaction through cash on hand and a new 105 -- \$145 million credit facility, utilizing a term loan totaling \$115 million. The combined pro forma leverage ratio is 2.1x adjusted EBITDA.

In calendar year 2016, NauticStar generated approximately \$63.7 million in net sales and will approach \$80 million in net sales for calendar year 2017. We expect NauticStar will contribute between 20% and 25% of the combined company revenue in fiscal 2018. And we expect it to be accretive to MasterCraft's earnings per share in year 1.

Our business generates strong free cash flow and our current plan is to use that cash flow in growth and earnings to delever our balance sheet. As Terry indicated, we look forward to leveraging our industry-leading strengths and operational excellence and financial management to further improve NauticStar's output, quality and margin as we continue the rapid growth.

I will now turn it back over to Terry.

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

Thanks, Tim. As said earlier, combined, we have the resources and experience to greatly expand NauticStar's distribution both domestically and internationally after satisfying the demand from the existing dealer network. We look forward to working together to deliver profitable and sustainable market share growth and driving efficiency in every area of our business.

At this time, I'd like to turn it over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Joe Altobello with Raymond James.

Joseph Nicholas Altobello - Raymond James & Associates, Inc., Research Division - MD and Senior Analyst

I guess first question, what's driving the growth in the top line that they saw in 2016 and what you guys are expecting or they're expecting in 2017?

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

Joe, they're a great brand and they have a great dealer network and their product is extremely well-built. Very excited about that, it's certainly a pull-through. Their wholesale growth is clearly a function of the strong retail they have based on the product, the quality and their strong dealer network. And when we looked at it, we were so excited about it as obviously we serve the fastest-growing segment in performance sports boats. And now we serve the fastest-growing propulsion segment in outboards as well as one of the fastest-growing segments in saltwater fish. So we're well-diversified now and we have no exposure to lagging or contracting segments.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD and Senior Analyst*

Okay, that's helpful. And maybe if you guys could give us a thumbnail sketch of what their margins look like, gross and EBITDA margins, compared to what MasterCraft is doing.

Timothy M. Oxley - *MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary*

Their margins are in the 17% to 18% range. Their adjusted EBITDA on an annual basis is in the \$10 million range. We're going to not try to be very specific on the numbers today. We're going to provide a lot more specifics in our upcoming earnings call. So that's it in a nutshell.

Joseph Nicholas Altobello - *Raymond James & Associates, Inc., Research Division - MD and Senior Analyst*

Okay. And just one last one, any cost savings? It sounds like it's pretty early at this point, so that's probably another first quarter conference call question.

Timothy M. Oxley - *MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary*

There certainly are cost savings. And we'll go over those during our conference call.

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

Correct.

Operator

And our next question comes from the line of Eric Wold with B. Riley.

Eric Christian Wold - *B. Riley & Co., LLC, Research Division - Senior Equity Analyst*

A couple of follow-up questions, more on the numbers. Can you give us a sense of average price point for boat and kind of what their current unit volume is? And then I know you're still working through kind of cost savings. But is there an opportunity to leverage from the manufacturing capacity in your Vonore facility to move some of their boats up there or their boats always be kept down in Mississippi during manufacturing?

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

Eric, this is Terry. I'll take the first part of that, then I'll flip it over to Tim. They will operate as an autonomous unit. We will keep them in Amory, Mississippi. They have a nice footprint of skilled labor. And we think it's best to keep them there. So one of the things, as you know, at MasterCraft,



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our focus on operational excellence is really a leading aspect and component of our company. They are -- as I mentioned in the prepared comments, demand exceeds supply, and we're going to go in and help them remove some layers of constraints to help them increase output. That is going to be a primary focus in the quarter through the end of this calendar year. And then we believe we'll have some initial constraints broken and be able to increase count beyond that. We, as you know, are averse to bricks and mortars. So we think there's 2 tranches to this output opportunity. And certainly, we believe we can, through better process flow and Lean Six Sigma, which we deploy here at MasterCraft, be able to get through the first hurdle. And then we'll evaluate concurrently whether or not we need to expand. But we believe we can do it without bricks and mortar at this time.

Timothy M. Oxley - *MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary*

Yes. Well, I'd like to reiterate that one of the kind of our subgoals is to not do anything that in any way that detracts from our core business here at MasterCraft. And that's one reason we're going to continue to manufacturing it in Mississippi and help those guys break their constraints. You asked about kind of an average unit selling price. And I would say in the \$36,000 range.

Operator

And our next question comes from the line of Tim Conder with Wells Fargo Securities.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Gentlemen, just a couple things here. One, how do you see the existing management team there? And maybe I don't know if it was the -- some of the owners that you're purchasing it from, are they tied up in that? Second would be related to your -- their dealer network and your dealer network. Any overlap and thoughts how you can leverage that, if there is, across? And then any opportunities at this point related to suppliers, whether it's the outboard engines, other type of supply agreements that may be out there with the company?

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

Right, Tim. This is Terry. So I'll address the first part of your question. Phil Faulkner and his partner, this is a complete, a 100% equity deal. Phil has been less and less involved in the day-to-day business since the beginning of this calendar year. Both Phil and his partner will not play a direct role in the business post transaction, although we've asked Phil to play an emeritus role. We very much like to see him help participate at boat shows and dealer meetings and so forth. The rest of the senior staff will be coming over. They're valuable. We value that as part of the transaction. And they will be coming over to help us. In terms of the dealer network, we only share one dealer right now. And the transaction was not based on trying to put NauticStar through existing MasterCraft dealers. As we made reference to in our prepared remarks, they are primarily an Eastern U.S. company. So they're from the Atlantic to the Mississippi and from the Canadian border down to the Gulf. And current demand exceeds supply. So we'll be breaking constraints, increasing output and satisfying the current dealer network, primarily. And once that's done, additional volume through our LSS efforts will go to -- we have plans to expand the network west of the Mississippi, we think certainly through Canada, Europe and Australia. So once we satisfy current dealer demand, we believe there's a great opportunity to expand internationally.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

On that, Terry, would you see utilizing the existing MasterCraft dealer network or maybe finding another new points of distribution? And then the other -- the last question I had was related to -- are there exclusive engine supply agreements? It look like they use Yamaha but -- and then on other supply chain type of opportunities.



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

Thanks, Tim. We look to have incremental distribution overseas. There may be a few points through existing MasterCraft dealers. But primarily, we believe we've identified incremental dealers that will augment their current dealer network. So that would not be reliant on existing international MasterCraft dealers. In terms of the engine supply, they have been 100% with Yamaha. Yamaha is excited about this transaction. We will remain 100% with Yamaha. And in terms of the other points of leverage, we believe there's some opportunities. They are part of the ABA already. And we'll enjoy that as well, and we're evaluating kind of on a component-by-component basis. But they are part of the ABA, and we look forward to continuing membership in the ABA.

Operator

(Operator Instructions) Our next question comes from the line of Craig Kennison with Baird.

Craig R. Kennison - Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst

So MasterCraft has a distribution philosophy. I think you give a larger network to your dealers, a larger area. Wondering what the philosophy is at NauticStar.

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

It's very similar, Craig, and we'll continue to -- I mean, that's our philosophy. We don't change that based on the brand that we own. And they've had a very successful, efficient, effective dealer network. And we'll continue that philosophy. So we're not looking to saturate in their existing areas, so there's so much room. We believe once we satisfy current demand that we can grow them west of the Mississippi, as I mentioned to Tim. And this is a great product for so many areas of the world. Internationally, we're very, very excited about the opportunity.

Timothy M. Oxley - MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary

I would add to that, that another part of our philosophy is we recognize the importance of the dealers being financially successful. And that will certainly be true with the NauticStar dealers as well.

Craig R. Kennison - Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst

And then just a follow-up on this capacity constraint issue that seems to be the case with NauticStar. You guys bring some Black Belt expertise and have done a wonderful job with MasterCraft. How much capacity can you bring without adding more capital expenditures?

Timothy M. Oxley - MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary

Well, we believe that there's an opportunity in terms of units to go initially without any additional capital of about 15% to 20% increase on the current units. And then once we get to Phase 2, we'll determine whether we need to add to the plant capacity. You know my stance on that. We really try to drive to do that without additional bricks and mortar.

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

And I'd say that we have a fairly decent chance of doing that. The current team have put a plan in place to expand the facility. They have physical room to do so. But we, during the transaction, said, "Let's put that on hold for right now," because we believe with our operational capabilities to be able to drive that to full capacity. And capacity constraints would most likely be an emissions output on their air permit. But we think beyond



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the 15% to 20% initial opportunity, that beyond that, once we achieve that level, there's a possibility to go up another 25% to 30% in unit output above that initial 15% to 20%.

Craig R. Kennison - *Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst*

And finally, just to clarify couple of comments from earlier. Was the \$36,000 average selling price a wholesale metric? And is the 17% to 18% margin metric for EBITDA?

Timothy M. Oxley - *MCBC Holdings, Inc. - VP, CFO, Treasurer & Secretary*

No, the 17% to 18% margin is a gross margin number. And the -- and the \$36,000 per unit is wholesale.

Operator

And our next question comes from the line of Rommel Dionisio from Aegis.

Rommel Tolentino Dionisio - *Aegis Capital Corporation, Research Division - Analyst*

So two questions. First, just to follow up on Craig's question on the gross margins, MasterCraft obviously enjoys this premium positioning in the marketplace. Could you just talk about the positioning of NauticStar relative to some of the other competitors in that sort of center console boat market? I mean, it sounds -- 36k sounds on the value price then, but that may differ on the length of the boat and so forth? Could you just talk about the prime position?

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

Sure. Sure, Rommel, this is Terry. Obviously, we are more of a premium brand in our niche in performance sport boat. I would characterize NauticStar as a mid-level product. It ranges over 3 distinct product lines from bay to deck boat to saltwater fish. So the wholesale unit Tim quoted is kind of a blended rate. It is important to note in the 18- to 28-foot category rolling 12, they have one of the highest growth rates of any company in that segment. If you look at that combined, just in saltwater fish, there's probably 100 competitors. So it's a very competitive market, which tends to drive down prices a bit. It's much more competitive than our niche in performance sport boat in terms of number of OEM players. But it was one of the things that was important for us to try to acquire a brand that was very complementary to MasterCraft. And they're an extremely -- NauticStar is an extremely well-built boat. It's got some really unique features to it. So we think it's certainly a very strong midline product. And you can see that in the retail results if you pull SSI data.

Rommel Tolentino Dionisio - *Aegis Capital Corporation, Research Division - Analyst*

Yes. And kind of just one follow-up question, if I could. The -- I wonder if it's possible to break down freshwater versus saltwater for NauticStar. And what I'm getting at is what potential is there to purely overlap with your own distribution network or dealer network on the freshwater market?

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

Yes. They're distributed and they sell to warm weather climates in particular. But they do have distribution that is pretty saturated throughout and well attended to throughout the Eastern United States, both fresh and saltwater. I don't have the ratio in front of me right now. We can supply that to you in our Q1 call. But again, as I mentioned to other guys that have asked questions, our goal is not to necessarily run this through existing MasterCraft distribution. It is a unique product. There might be a couple of dealers there. But we respect dealer territories. We respect the current dealer territories at NauticStar. It's unique. Years ago, when I was Vice President of Sea Ray Group, Boston Whaler was one of the brands that I was



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responsible for. So I think we have a good understanding. And I think that augments well in terms of using the dealers and having a dealer network that knows how to properly position and sell these products. It is -- as our product is at MasterCraft, it's unique. And unique dealers that understand that and live that lifestyle, it's just as important to have dealers that know these type of products as well. So we don't have any big plans to try to push this through in a big way through our existing MasterCraft dealer network.

Operator

And that concludes our question-and-answer session. I'd like to turn the floor back over to Terry McNew, Chief Executive Officer, for any final comments.

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

Thank you, operator. Once again, thanks to everybody for joining us this morning. And to reiterate, we have the resources and experience to greatly expand NauticStar's distribution both domestically and internationally after satisfying the demand from the existing dealer network. We look forward to working together to deliver profitable and sustainable market share growth and to drive efficiency in area of our business. And we look forward to updating you on our progress in the future at our Q1 call scheduled November 9. Thank you.

Operator

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

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