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MCFT - Q1 2018 MCBC Holdings Inc Earnings Call

EVENT DATE/TIME: NOVEMBER 09, 2017 / 10:00PM GMT

THOMSON REUTERS

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Q1 Fiscal '18 MCBC Holdings, Inc. Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to introduce your host, Mr. Tim Oxley, Chief Financial Officer. Sir, you may begin.

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

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 is Terry McNew, MCBC Holdings' President and Chief Executive Officer.

Our agenda includes a strategic overview by Terry, followed by my analysis of the financials. Then Terry will discuss our strategies for growth and expectations for fiscal 2018, followed by 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, November 9, 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.

Additionally, on this conference call, we will discuss non-GAAP measures that include or exclude special or items not indicative of our ongoing operations. For each non-GAAP measure, we also provide the most directly comparable GAAP measure. Our fiscal 2018 first quarter earnings release includes a reconciliation of these non-GAAP measures to our GAAP results.

Before turning the call over to Terry, I would like to remind listeners that there is a slide deck summarizing our financial results in the Investors section of our website.

With that, I will turn the call over to Terry.

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

Thanks, Tim. I'd also like to thank everyone for joining us today. As you saw from today's press release, top line sales grew nicely in the first quarter driven by solid retail demand, and we continued to deliver outstanding working capital management. Additionally, we recently welcomed NauticStar to the MasterCraft family. NauticStar is a well-respected, expertly built and uniquely positioned brand, and their outboard bay, deck and offshore center console boats provide us with additional product diversity and opportunities for growth going forward.

With more than 15 years of boat manufacturing experience, including a 200,000 square foot manufacturing facility, NauticStar is a reputation for reliability, quality and consistency with a loyal network of dealers and customers, including professional and sport fishermen and recreational and pleasure boating enthusiasts. Moreover, they provide us with a presence in 3 distinct subcategories: bay, deck and saltwater fishing, all powered by outboard propulsion, which is the fastest growing propulsion category. Additionally, 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 strength and operational excellence and financial management to further improve NauticStar's output, quality and margin as we continue their rapid growth.

Since acquiring NauticStar, we've brought onboard Tim Schiek, a 22-year marine industry veteran, as NauticStar's new President. Tim spent more than 20 years with Brunswick Corporation, serving in a variety of leadership roles. Additionally, he has successfully run multiple well-known marine brands and brings key financial operational and dealer relationship experience.

On the recognition front, I'm pleased to announce that the American Boatbuilders Association, or the ABA, nominated and unanimously voted MasterCraft for inclusion into its prestigious buying group. The roster of membership in the ABA is an industry who's who of strong, independent boat manufacturing companies. This membership is a significant benefit for the MasterCraft brand from many perspectives.

Looking ahead to our fiscal year, we're optimistic about prospects with the sales and profit growth opportunities we have for both NauticStar and MasterCraft. And we remain committed to our 5-pronged growth strategy: developing new and innovative products, further penetrating the entry level and midline segment of the performance sport boat category, capturing share from adjacent boating categories, strengthening our dealer network and driving margin expansion through continuous operational excellence. This combined commitment to operational excellence and innovation, teamed with our strong, diverse product portfolio, positioned the company well for fiscal 2018 and beyond.

Now I'd like to turn the call back over to Tim to go over our financials.

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

Thanks, Terry. As a reminder, the first quarter results I'm about to discuss reflect MasterCraft only, since NauticStar was acquired on October 2, 2017, post first quarter close. Going forward, our consolidated results will include both MasterCraft and NauticStar.

From a top line perspective, net sales for the first quarter rose $4.3 million or 7.2% to $65 million from $60.7 million for the prior year period. The increase reflects a 57-unit or 7.9% rise in unit sales volume and favorable pricing offset by product mix.

Gross profit for the first quarter increased $0.4 million or 2% to $18.2 million versus $17.8 million in the prior year period. Gross profit margin decreased to 27.9% from 29.3% for the prior year period. The increase in gross profit resulted from rise in unit sales volume and was partially offset by unfavorable product mix and an increase in model-year changeover cost as we added significant new boat features to our 2018 models. This resulted in a gross margin decline when compared to the prior year period.

On the expense front, selling and marketing expense increased $0.7 million to $2.7 million for the first quarter compared to the year-earlier quarter, primarily due to increased dealer training cost and increased promotional activities with the introduction of the redesigned 2018 MasterCraft XStar. General and administrative expense totaled $4.3 million versus $4.1 million for the prior year period. This increase stemmed mainly from a rise in advisory fees related to the NauticStar acquisition, partially offset by a decrease in litigation costs.

Turning to the bottom line. Fiscal first quarter net income totaled $7 million, which was the same as the year-earlier quarter. Adjusted net income was $7.5 million or $0.40 per share on a pro forma, fully diluted weighted average share count of 18.8 million shares. This compares with adjusted net income of $7.6 million or $0.41 per share in the prior year period.

EBITDA was $11.8 million compared to $12.4 million in the prior year period. Adjusted EBITDA margin declined 200 basis points to 19.9% from 21.9% in the prior year period. Adjusted EBITDA was $12.9 million, a 2.8% decrease from $13.3 million in the prior year period. See the Non-GAAP Measures section included in today's press release for a reconciliation of adjusted EBITDA, adjusted EBITDA margin and adjusted net income to the most directly comparable financial measures presented in accordance with GAAP. Keep in mind that Q1 last year was by far our most profitable quarter and, therefore, represents a difficult comp. Q1 this year exceeded our internal budget, and the guidance for the year for MasterCraft remains unchanged.

With that, I will turn it over to Terry for our outlook.

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

Thanks, Tim. We delivered solid fiscal 2018 first quarter performance, and we're optimistic about the future. For the fiscal 2018 second quarter, we expect net sales growth in the 45% range and adjusted EBITDA margin to be above 15%. Both MasterCraft and NauticStar's top lines are growing in the mid- to high single-digit range compared to the prior year.

For the fiscal 2018 full year, we anticipate net sales growth in the 35% range, with NauticStar representing approximately 20% of the full year net sales, based on 3 quarters of post-acquisition results. Adjusted EBITDA margin will be in the mid- to high 17% range after adjusting for the dilutive effect of NauticStar. MasterCraft's adjusted EBITDA margin is expected to grow to the low 19% range, as previously guided. Adjusted EPS is expected to grow by over 25%. NauticStar will provide accretion of $0.15 to $0.20 per share during the 9 months post acquisition.

Now 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 Eric Wold from B. Riley.

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

A couple of questions. I guess, one on the gross margin in the first quarter, the unfavorable product mix. Any additional details around that? And do you get a sense that's kind of the mix that should continue for the core MasterCraft side for the remainder of this year? Is there anything -- any special in the quarter that could cause that?

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

Eric, we had a challenging model-year changeover this year, and we brought a lot of new items to market. All of that is behind us, and we're at full run rate now. And as Tim mentioned in our prepared comments, last year's Q1 was by far the most profitable quarter in our history of our company. So it's a difficult comp. We are ahead of our internal budget, so we actually feel pretty good, and we're still holding to the full year guidance.

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

Perfect. And then on the competitive environment, just can you maybe give a sense of what you're seeing out there, both in the core MasterCraft side as well as now Nautic in terms of any increased promotional activity by competitors? Or is it staying relatively healthy?

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

We don't have great visibility into what our competitors are doing. However, for us, our promotional activities are very consistent with the prior year, and we're not hearing anything coming from the dealers. So I would say the promotional environment is fairly benign right now.

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

And then, last question, kind of thinking about the guidance -- the net sales guidance for '18 and with NauticStar about 20% of that. Curious, kind of high level, what are you assuming in there in terms of your ability to go in there and boost their output from what they're doing prior to the acquisition? Is it -- how much of that gain -- or how much of that -- the benefit will you see in this year's numbers? And how far along are you on that process?

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

We're at or slightly ahead of what we anticipated, Eric. We have 3 main areas that we're really focusing on with NauticStar. One, breaking their production constraints, improving housekeeping and safety, of course, and then adding dealers, especially internationally. We had our call October 2, the morning of the transaction. We're holding tight to that. And I would say that we're slightly ahead of schedule in terms of breaking the production constraints.

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

And then the guidance assumes some improvement from what they were doing before or kind of [new]?

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

(inaudible)

Operator

Our next question comes from the line of Craig Kennison from Robert W. Baird.

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

A question, I'm sorry if I missed this, but were you able to quantify the change in retail or inventory in the quarter? I know, in quarters past, you've been able to break out retail metric out.

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

The only time we've really talked about retail for the quarter was in Q3 last year because it was such an aberration from kind of the norm. We're very comfortable with our dealers inventory level, and the turns are up slightly. And at the same time, since we've added some points of distribution, turns are always calculated on a trailing-12 basis, and so that gives us additional confidence [no matter] the inventory to dealers are holding.

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

And Tim, how do you plan to present NauticStar in the financials? Is this going to be a separate entity with different breakdown of units and ASP?

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

Yes. There'll be segment reporting for NauticStar.

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

And then finally, with respect to regional trends, what are you seeing regionally? And any impacts from, for example, the hurricane or anything like that?

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

There really hasn't been, knock on wood, any interruptions with either of the hurricanes. We're very positive, both at NauticStar and at MasterCraft, virtually no impact from either hurricane. Texas remains the largest state for us at performance sport boats at MasterCraft. We've added a dealer in Southern California. We've added a couple of dealers throughout Europe and North America as well. So we're very happy. Geographically, we're just seeing very good, consistent contribution throughout the world.

Operator

Our next question comes from the line of Joe Altobello from Raymond James.

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

So first question, I guess, big picture, the guide this afternoon, what does that bake in, in terms of the overall market growth you guys are expecting over the next few quarters? Is it similar to the growth rate we've seen over the last few quarters here?

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

Yes. I would say, as far as market growth for performance sport boats, it's growing kind of mid-single -- yes, mid-single digit. And then for the NauticStar segment, they've got kind of 3 subsegments, and so I'm not as familiar with how that segment is growing. I looked at some reports just today, and it is certainly growing. I would say it would be mid- to high single digit.

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

Okay, that's helpful. And then in terms of the NauticStar accretion, I think you mentioned it's going to be $0.15 to $0.20 for this year for 9 months. Are there cost synergies baked into that? Number one. And number two, the NauticStar ASP that I think you mentioned on the last call when you announced the deal, that the ASP is around $36,000. Is that still the case?

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

That is still the case. The types of synergies we have with NauticStar includes helping them break their capacity constraint. When we acquired the company, their plan was to spend $1 million on bricks and mortar to break the capacity constraint. With our process improvements that we're planning, we expect to be able to do that with nominal capital. And we do have operational synergies, reductions of labor variances and other things. But because of the kind of top line growth and adding distribution and particularly internationally, it's a little bit harder to discuss synergies. I think the key thing is focusing on the $0.15 to $0.20 per share accretion for the 9-month period, and I think that's what's most important.

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

Okay. And then just one last one, if I could. I thought your tax rate was going to go down, given the changes to the Tennessee state tax code, but it looks like you guys are still using 36%.

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

Yes, the reason we use 36% is we think it's better to evaluate the company at a consistent tax rate. So our actual tax rate is less than 36%. We've had previous periods where it was higher than 36%. And we want to really take out the noise of changing the tax rate for the investor. And so when we calculate our adjusted earnings per share, we're using a consistent 36% rate, but we did get the same favorable benefit of the Tennessee change in their methodology.

Operator

Our next question comes from the line of Michael Swartz from SunTrust.

Michael Arlington Swartz - *SunTrust Robinson Humphrey, Inc., Research Division - Senior Analyst*

Just wanted to follow on the commentary about, I guess, some of -- maybe some of the complexities that you saw with the model-year '18 changeover. Just to get a little more color on those. And I think you did say that, that's now behind you, but just a little more color will be helpful.

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

Yes, Mike. This is Terry. We brought on several new features to our product line this year, model-year '18, specifically the new dashes, ZFT2 towers are base now for our product. There were several other components as well that we've brought onboard.

Michael Arlington Swartz - *SunTrust Robinson Humphrey, Inc., Research Division - Senior Analyst*

The sound system, are we talking about that?

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

Exactly. Absolutely. So we got that behind us in Q1. We're at full rate for the entire month of October, and we're really in pretty good shape.

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

Every year, we look at whatever we're going to take on, and we recognized this was kind of the most challenging part for manufacturing that we've had in several years, and so we didn't execute it flawlessly, but the good news is that's behind us.

Michael Arlington Swartz - *SunTrust Robinson Humphrey, Inc., Research Division - Senior Analyst*

Okay, that's helpful. And then just on the sales and marketing cost. I think you said you had some additional costs related to the launch of the new XStar. I guess, why were there additional costs related to that? And any way you -- we can quantify how much that was?

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

Sure. Yes, the additional cost, as you probably know, the XStar was one of our 2 kind of halo products, the other one being the ProStar, and it's a big deal when we launch that new XStar. And so we beat the drum, which cost a bit more money. We're comparing that to the launch of the XT20 or 21 last year in September, and that product required nearly as much in promotional activities. I don't recall exactly how much that was, but certainly, that and the additional dealer training is where that drove the sales and marketing expenses up.

Michael Arlington Swartz - *SunTrust Robinson Humphrey, Inc., Research Division - Senior Analyst*

Okay, great. Then the other question I -- just in terms of how we're thinking about the quarters with NauticStar, do they have a similar seasonality as the core MasterCraft business?

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

They're similar to the MasterCraft business. They probably see a little bit higher Q3 than we do in performance sport boats. But generally, you can look at it, from a retail sales perspective, it's very close.

Michael Arlington Swartz - *SunTrust Robinson Humphrey, Inc., Research Division - Senior Analyst*

Okay. And then just finally, maybe for Tim, how are we thinking about interest expense this year with the additional debt?

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

Yes. We were very pleased to negotiate favorable terms, about 100 basis point reduction at the same -- at a comparable leverage ratio. So that, we we're very pleased with. It's going to run 3.5 to 3.8 or 3.9 this year, including the amortization of deferred financing costs. So all in, it's around 3.7, 3.8, somewhere in there.

Operator

Our next question comes from the line of Rommel Dionisio from Aegis.

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

Yes, so question on the NauticStar integration. If you guys hit your -- the targets that you've laid out in terms of accretion, obviously, your supply chain at MasterCraft has been pretty stellar for quite some time, and I realize you're going to bring a lot of those synergies and operational practices there. Would you say that -- by the end of this fiscal year, assuming you hit the targets that you've laid out today, where would you be at that point in terms of that integration process and bringing them up to your supply chain excellence that you guys have? Would you be, at that point at the end of fiscal year, the second inning or the fifth inning or the eighth inning? Could you maybe give us some flavor as to how quickly -- without asking for fiscal '19 guidance, how much more runway you might have for improvement on the [splotch] in there?

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

I think the majority of our integration costs, in particular, are going to occur in the first quarter post acquisition, which is the December-ending quarter. And even then, those costs are fairly moderate with legal and professional and the other things were kind of at the start of the company and their acquisition. I would say, by the end of the year, many of the things that we want to accomplish will have been done. But keep in mind that just like MasterCraft, in our spirit of continuous improvement, NauticStar is never going to get across the finish line in that regard either. So what we're focusing on at NauticStar, quality, safety, delivery, are the same things we focus on here at MasterCraft.

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

Okay. And maybe one question as we look at the selling and marketing expense. Are you maybe holding back a little -- is there a thought to maybe hold back a little bit on the NauticStar marketing support, just given that you're capacity-constrained at the moment, and perhaps see that ramp up as time goes on? Or are you still sort of maintaining a pretty healthy sort of marketing prudence?

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

Yes. We're -- we have brands positioned very differently in NauticStar versus MasterCraft. And so those guys are going to continue to operate very autonomously. And so we'll give them advice on marketing, but we're -- they're going to be making the calls. And their marketing spend traditionally has been less than MasterCraft's, as you would expect from sort of a midline brand, and I would expect that to continue.

Operator

Our next question comes from the line of Laura Engel from Stonegate Capital.

Laura Shelmire Engel - *Stonegate Capital Markets, Inc., Research Division - Senior Research Analyst*

Actually, a lot of them have been answered. So I wanted to see, just related to the announcement on the ABA membership, I'm just curious, other than being a collaborative group,it talks about purchasing power gained through the group, can you give us a little bit of detail on that, what that opportunity is?

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

Sure. We've been a member of that group for such a short period of time. We do anticipate some cost savings, but it's too soon for me to quantify that for you. But we do expect some cost savings from that participation.

Operator

And I'm showing no further questions, and I would now like to turn the call back to Terry McNew, Chief Executive Officer, for any closing remarks.

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

Thank you, operator. Once again, thanks to everyone for joining us this afternoon. Across the organization, we are well positioned for fiscal 2018 and beyond. We look forward to updating you on our progress and second quarter results in February. Thank you.

Operator

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