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MCFT - Q1 2016 MCBC Holdings Inc Earnings Call

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Terry McNew *MasterCraft - President and Chief Executive Officer*

Shane Chittum *MasterCraft - Chief Operating Officer*

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Rommel Dionisio *Wunderlich Securities - Analyst*

Joe Hovorka *Raymond James - Analyst*

Mike Swartz *SunTrust - Analyst*

Craig Kennison *Baird - Analyst*

Tim Conder *Wells Fargo - Analyst*

Jimmy Baker *Riley - Analyst*

QUESTIONS AND ANSWERS

Operator

Thank you. Ladies and gentlemen, if you have a question at this time, please press the star then the number one key on your touchtone telephone. If your question has been answered, or you wish to remove yourself from the queue, please press the pound key. Again, that's star and one to ask a question. And our first question comes from the line of Jimmy Baker, with B. Riley. Your line is open.

Jimmy Baker - *Riley - Analyst*

Hi, good afternoon. Great quarter and thanks for taking my questions.

Unidentified Company Representative

Hey Jimmy.

Jimmy Baker - *Riley - Analyst*

So, a couple questions here just on your new model introductions that are coming. I think you mentioned two more still to come this year. Are these refreshes or white space opportunities, and can you maybe just provide a little bit of color as to how those launches will impact the quarterly cadence of your shipments.

Tim Oxley - *MasterCraft - Chief Financial Officer*

Right, so anytime we talk about our portfolio, they are complete re-tools. They are not refreshes as defined by maybe a new deck or some new graphics. Typically we handle that through model change.

These are completely new models, from their tool - and they are not expected to impact our output in any significant manner, in fact, we have been at this cadence for a little over two and a half years. Due, out of respect for our desire to have a proper marketing launch, we are not really



saying what models those are, but we have three very predictable releases every single year, one in the spring and one in the fall, and one in the mid-winter season.

Jimmy Baker - *Riley - Analyst*

OK, that's helpful. And then maybe you could just talk a little bit about dealer inventory exiting the quarter. How does that look, you know, year over year, and how would you parse that out if you could between domestic versus Canada?

Tim Oxley - *MasterCraft - Chief Financial Officer*

Yes, we look at our dealer inventory on a regular basis and we are very comfortable with the level of inventory that the dealers have. And even though we've had headwinds in Canada, we have adjusted production accordingly and that has been baked into our guidance, you know, and the same thing with the rest of the world.

Jimmy Baker - *Riley - Analyst*

OK, and last question from me. You're looking for, you know, at least 200 basis points of increase in the EBITDA margin this year - really strong performance. I guess what's the, kind of, sustainable incremental margin if we look beyond this year, and how would you frame the long term margin opportunity for the business?

Terry McNew - *MasterCraft - President and Chief Executive Officer*

Jimmy, this is Terry - really just looking at guides for 16 so we are not providing anything out beyond that. The way we look at our business is the first quarter is generally favorable for us in regard to EBITDA net income because (inaudible) tend to choose those new options at the beginning of a model year due to the dealers bring the boats in.

And we are kind of on the dark side of the moon as far as retail, so they bring them in a little lightly equipped and then as boat show season kicks in, you know, you start seeing more retail names on orders and those generally people are selecting specific options because they are a little bit more retail sold. So, that's kind of the rhythm we see throughout the year.

Jimmy Baker - *Riley - Analyst*

OK, helpful. I appreciate the color. Thanks guys.

Unidentified Company Representative

You bet. Thanks for joining us Jimmy.

Operator

Thank you. Our next question comes from the line of Rommel Dionisio with Wunderlich Securities. Your line is open.



Rommel Dionisio - *Wunderlich Securities - Analyst*

Yes, thanks very much. You know, just a question about the international markets as you seen some currently fluctuations and sort of things you lute to in Canada and other markets.

Are you seeing any sort of - you know, I know it is a strategic initiative to really grow that dealer network, that distribution network oversees - are you seeing any sort of slowdown in that process or that progress your making in that - thanks.

Tim Oxley - *MasterCraft - Chief Financial Officer*

No, we are not Rommel. This is Tim. You know, it continues really, and it's not been a - slowed down by the currency. Because frankly, in most countries, with the exception of Australia, we are competing against other U.S. manufacturers so we are all kind of facing the same headwinds as it relates to foreign currency.

As Terry mentioned, we invoice in U.S. dollars so the foreign currency impact, you know, impacts obviously the price the consumer is looking at.

Rommel Dionisio - *Wunderlich Securities - Analyst*

Just as a follow up to that Tim. Given the Arbres currency situation that these guys face in foreign markets - are they, is the health of those dealers still relatively steady, or are they, you know, surviving sort of a difficult period here?

Tim Oxley - *MasterCraft - Chief Financial Officer*

Yes, that's a good question and they are healthy, and in particular because we cut back our production, we want to make sure that we don't stuff dealers and so our dealer inventories and our dealers are healthy internationally.

Rommel Dionisio - *Wunderlich Securities - Analyst*

Great, OK. Thanks very much.

Unidentified Company Representative

Sure.

Operator

Thank you. Our next question comes from the line of Joe Hovorka, with Raymond James. Your line is open.

Joe Hovorka - *Raymond James - Analyst*

Thanks guys. A couple quick questions. First, did you mention what retail was in the quarter for the U.S. market and then I am specifically interested in what Canadian retail looked like as well in the September quarter.



Terry McNew - *MasterCraft - President and Chief Executive Officer*

(Joe), this is Terry - no, we did not mention that. So (inaudible) dated this out, you know, kind of spelled that out what the growth was in the quarter. We were slightly ahead of that.

We are very pleased with our market share gains, all states not reporting yet through September, but each of the consecutive months in the quarter, July, August and September we saw market share improvements. The typical algorithm for us as we add to the final states report, we generally increase market shares, so we are very positive on that.

Joe Hovorka - *Raymond James - Analyst*

And what did Canada look like?

Terry McNew - *MasterCraft - President and Chief Executive Officer*

Don't have specifics on Canada, that data is a little harder to come by, but as Tim mentioned, what we have done with all of our Canadian dealers looking forward is that we have helped them adjust their 2016 orders so that we don't build inventory unnecessarily there.

And they have been very receptive to that. Out west, obviously oil plays a bigger part - the currency certainly is hitting all of Canada. Some of the positives we see is the elections - recent election results in Canada seem to be bolstering consumer confidence which is super important.

Some of our dealers in the eastern part of Canada have actually seen some positive gains but overall it feels like (Joe) we are probably nearing a bottom net of any other significant event in Canada, but we don't expect a quick rebound.

But I think everybody is settling into the currency levels. And of course, oil is just rating in between \$45 to \$50 a barrel so, I think what we are hearing when we talk to our dealers out in western Canada is that Canadians are kind of coming to adjust to that just like we did in the U.S. back in '08 and '09.

And, they are just kind of getting their expectations in all sorts of purchases in line, and adjusting their budgets, so. Again, we work very closely with our Canadian dealers on inventory and as Tim said, we are very - we feel very comfortable with it and all the effects issues - again, we don't have currency, direct currency issues related to effects, because we invoice in U.S. dollars but the unit volume adjustments are all baked into our 16 guides.

Tim Oxley - *MasterCraft - Chief Financial Officer*

And (Joe), this is Tim, I would like to add that when we look at our retail sales in Canada, our (inaudible) basis - it's still fairly strong and I think that Canadian viewers are smart and they have gotten in front of this and anticipate, you know, decreases in the future, and so we have adjusted, you know, the production plan accordingly.

Joe Hovorka - *Raymond James - Analyst*

Great, and just one last question, on the X26, I know that the X55 came out of line at the same time as the X26 come in - what's the order book look like for the X26 versus the model that left the lineup?



Unidentified Company Representative

Well, it's much stronger on - the 55 had been in our portfolio for a few years and it was just shy of - it was about 6 years old and the X26 is just - it takes on the new styling that really, that we really started to change over to about three to four years ago on the exterior surfacing.

It has the optional (inaudible) or, you know, bathroom and optional wet bar, and it has an optional refrigerator. It's got seating for seating capacity to - based on weight but equivalent to 18 people can enjoy the boat - it's got a very unique seating configuration in the water sports activity wake behind it is exceptional. We are getting really good comments on that.

So, it's - the book is building a little bit quicker than we anticipated, and we are very, very pleased with it, and initial comments from both dealers and some consumers are very, very positive on it.

Joe Hovorka - *Raymond James - Analyst*

That's all I've got, thanks.

Unidentified Company Representative

All right, thanks (Joe).

Operator

Thank you. And again ladies and gentlemen, if you have a question at this time, please press the star and the number one key on your touchtone telephone. Our next question comes from the line of Mike Swartz, with SunTrust. Your line is open.

Mike Swartz - *SunTrust - Analyst*

Hey good afternoon guys.

Unidentified Company Representative

Hi Mike.

Mike Swartz - *SunTrust - Analyst*

I just following up - and Tim I think we - I believe you guys have said you've adjusted production just given that (inaudible) from the slowdown that - what everyone is seeing in Canada. Did that come recently, or is that something that you had made a decision on a couple quarters ago?

Tim Oxley - *MasterCraft - Chief Financial Officer*

What I meant when I said we have adjusted production - we have taken it to consideration when we put our production schedule together. So, we haven't adjusted production downward but our production plan has taken a consideration, you know, the softness in the international markets.

Terry McNew - *MasterCraft - President and Chief Executive Officer*

Mike, this is Terry.

Mike Swartz - SunTrust - Analyst

OK.

Terry McNew - MasterCraft - President and Chief Executive Officer

Add on to that, you know, we started obviously seeing that in January, I think everybody did, when the currency started turning around unfavorably and as we have mentioned before, we have a unique operating capability - we have a very flexible manufacturing system and we watch dealer inventory around the world every dealer - by dealer, every Monday, and we have built a system where we can change mix every single week.

So we are very much a cool base system, not a push base system. So, we haven't changed count in several quarters, but we changed the mix.

Mike Swartz - SunTrust - Analyst

OK, that - just looking for if that was already built into your prior guides (inaudible).

Unidentified Company Representative

Yes.

Mike Swartz - SunTrust - Analyst

OK, great. And then just on the - now that you have about a quarter, a little more than a quarter under your belt on the NXT22, can you maybe give us a feel for, you know, the experience you are seeing there in terms of retail volume maybe versus the NXT20 that you introduced a year ago.

Unidentified Company Representative

Yes, well the NXT22 just released at the beginning of the model year, but we are seeing very expected sell through rates, you know, the NXT20 started the beginning of fiscal year of 15 and it enjoys one of the, if not the highest sell through rate in our portfolio.

And the NXT22 we expect it to be as high, or higher. Initial indications compared to where the NXT20 was at this time last year support that, and the NXT20 is targeted at the 22 foot category or segment of the entry-level portion of this category which is the highest by volume in the entry-level portion of the performance sport boat categories. So we are very, very pleased with that.

Mike Swartz - SunTrust - Analyst

OK great.

Unidentified Company Representative

I've had - the dealer feedback, they are very, very positive in particular that 22 foot boat is obviously a little better and bigger water, so the dealers that are on the big water are very, very excited about it.



Mike Swartz - *SunTrust - Analyst*

Great, and then just a final question. Looking at gross margin, this quarter and understanding, you know, the whole kind of aspect of dealers - going into the [boatshares region] and putting as many options and high end features on the boats as possible - can you really just give us a feel for just the drivers, individual, you know, bucket (inaudible) laid out - just, I guess the pecking order or some kind of rank in that how they contribute to that 390 basis points.

Unidentified Company Representative

They being the dealers? Or are you talking about how boats are typically specked out over quarter?

Mike Swartz - *SunTrust - Analyst*

No, no, I am just - I'm just talking about in the gross margin improvement over year, what - and you laid out some of the buckets, which were the more impacted, from maybe most to least?

Unidentified Company Representative

Yes, you know, I think that the - it's probably proper to say that about a hundred basis points of the improvement is associated with replacing the lower margin Hydra-Sports, with higher margin MasterCrafts, that's fairly easy to quantify.

I really don't have a quantification of, you know, cost reduction versus a higher margin options and the continuous improvement initiatives are in place. We haven't bifurcated those into categories. Shane do you have, you know, anything you can add to that?

Shane Chittum - *MasterCraft - Chief Operating Officer*

No, I think Tim's - I think when you look at all the nature of all those other categories they all equal equally contribute to that, so I mean we have an effective purchasing strategy here, we continue to leverage our product in process knowledge as we introduce new models and we expand accordingly, and certainly we get a lot of fruit from our continuous improvement efforts related to cost reductions under our VADE and the introduction of new options that model year.

Unidentified Company Representative

Sure, and it's really a stack up of all those things that gets us at 390 basis points improvement that we are looking at.

Mike Swartz - *SunTrust - Analyst*

OK. Thanks guys.

Unidentified Company Representative

Sure. Thank you.

Operator

Thank you. Our next question comes from the line of Mr. Craig Kennison with Baird. Your line is open.

Craig Kennison - Baird - Analyst

Hi, good afternoon. Thanks for taking my question.

Unidentified Company Representative

Hey (Craig).

Craig Kennison - Baird - Analyst

I wanted to - hey. I wanted to start with news that a competitor had recently matched your five year warranty. I am wondering if there are important differences between the warranties being offered and - as a follow up, how important in general is the warranty as a differentiator?

Unidentified Company Representative

You know, we came out with it in the beginning of model year 14. We had confidence in the quality processes that we were putting in place even prior to that and, you know, we are consumers as well, so we felt the brand certainly supported it, we have superior material selection and then our process is validated by our three ISO certifications and being recognized by IndustryWeek as a finalist each of the last two years support that.

We try to make it very easy for the consumers and our dealers but really it's pretty straightforward - five years is five years, there are some exceptions on paint, on the trailer in gelcoat for scratches, just like it would be on your automobile. But other than that, its five years and its being well received, in fact, consumers and dealers have told us recently that it is becoming more and more of a reason to buy.

In fact, I've had several customers that talked to me as I am out and about, and said it is the specific reason they bought, and it gives them a great comfort level. What we also like about it is that it's now entering its third year and that it's a one-time transferable warranty and because MasterCraft - because of the quality and the material selection generally hope their very good resale value that's allowing people to trade in and hold the residual value and so it's easier for them to trade up into our portfolios.

So, it's been a very, a very important part of our strategy, and we will continue it - it's not dilutive that a gross margin that all our quality systems are very efficient.

Unidentified Company Representative

I would add that it wasn't until we really improved our quality levels that we felt like we could afford the five year factory warranty - so, we couldn't have done this five years ago, and Shane and his team have done such a nice job of improving quality that we were able to offer the five year factory warranty.

Craig Kennison - Baird - Analyst

Yes, and I wanted to follow up on that - to what extent do you think you have a warranty experience benefit. In other words your ISO certification leave you with less warranty cost than maybe competitors?

Unidentified Company Representative

Yes, absolutely. One of the things that we saw immediately were - in the beginning of the second year competitors would try to indicate that they had a five year warranty but it was clear that it wasn't the same as ours.

We put a boat buyer guide together at the beginning of the boat sale season this calendar year that shows that and consumers came to us in a big way through our dealers as well as directly to us saying yes, there is a significant difference.

What, you know, we think that the competitors we have seen recently, a major competitor tried to match that - what's unique with us, and Shane can expand on this - is our ability to execute, it does not cost us more and Shane can go into that in a bit more detail.

Shane Chittum - *MasterCraft - Chief Operating Officer*

Yes, as you can imagine (Craig), this is Shane - I mean our customers deserve and demand the highest level of quality in the marketplace, and just being able to give a warranty and not deliver on that promise is not a strategy that we put in place.

As Tim was mentioning, we didn't get to a point in our quality journey, you know, we got to a point in our quality journey where we were able to back that up, and I think one of the ways that gives us assurance as a management team is we continue to look to third party authentication.

Our (inaudible) customer service indexes for the last two years have been above the national averaging and continue to grow year over year in the past year, our warranty run rates despite increasing our warranty terms have improved, along with all of our internal first time process in quality inspection metrics and as Terry mentioned in his initial commentary, for the second year in a row, we have been selected as IndustryWeek's best manufacturing in North America and you can't get that without significant improvement in quality.

Craig Kennison - *Baird - Analyst*

No, that's very helpful. Tim, question for you. With all of the outstanding debt now repaid, what would the priorities for cash be today?

Tim Oxley - *MasterCraft - Chief Financial Officer*

Right now we like the fact that we are - we have eliminated all of our debt, we are flexible, we are evaluating all of our alternatives, we have mentioned previously we are looking at, you know, possible vertical integration opportunities and so we are just looking in strategic initiatives that are going to add to value to our shareholders.

Terry McNew - *MasterCraft - President and Chief Executive Officer*

(Craig), this is Terry, I will just add two points. We think our two primary core competencies are financial management and operational excellence. So we are looking for opportunities to take advantage of investments where we can leverage that quickly and our goal is to any acquisition that we might do vertically or otherwise would have to be creative in year two and beyond.

Tim Oxley - *MasterCraft - Chief Financial Officer*

And I don't have a problem with that in cash on the balance sheet until we find the right opportunity.

Terry McNew - *MasterCraft - President and Chief Executive Officer*

Correct.

Craig Kennison - *Baird - Analyst*

Oh, that's helpful. Thanks guys.

Unidentified Company Representative

Thanks (Craig).

Operator

Thank you. And our next question comes from the line of Tim Conder, with Wells Fargo. Your line is open.

Tim Conder - Wells Fargo - Analyst

Thank you, and gentlemen, to (Craig)'s previous question, same discipline, sitting on the cash rather than forcing something we totally agree, so - good strategy. Is it related to vertical integration - I think you had mentioned before that there were some opportunities, I mean granted everything has to be at the right price, but, what type of probability would you put on something like that happening in the next 12 to 18 months versus if your cash continues to build, would you then say hey, we have reached the point where we are going to have to look at where the stock prices, if that makes sense?

So, that's question one, and I appositive here if you've answered question two, got on a tad late - can you talk about cadence of sales trends in states like Texas. It sounds like there is not a major issue on the channel at all but just how those have trended here over the last 90 to 120 days. Thank you.

Shane Chittum - MasterCraft - Chief Operating Officer

Tim, this is Shane, I will take the first question, and then I will give the second one to Terry. You know, we are vertically integrated in trailers and we are vertically integrated in upholstery and we continue to, you know, look for strategic opportunities given the sensitivity of our industry and the nature of that, you know, we can't get into the details of that, but as we have mentioned and shared in the past, we have two strategic initiatives, we are continuously evaluated and qualified in a medium probability in the next 12 to 18 months to execute such.

Tim Conder - Wells Fargo - Analyst

OK.

Terry McNew - MasterCraft - President and Chief Executive Officer

Tim, this is Terry. You know, the U.S. has been strong in nearly every region. The slight exception would be California, obviously related to the drought, although the dealers still show that there is some strong demands, they are just obviously restrictions out there as far as water is concerned.

We are very pleased with the addition of appointed distribution in central California - that's been a good add for us. But really, everywhere we are not hearing any feedback that it's slowing down. It's near equal across all regions. Certainly the water in June in Texas has helped.

In addition to that, we have worked with our Dallas boat dealer to put in an additional point of distribution in Dallas, and that has had an immediate impact on units and commitments of up to about 60% for that dealer in particular. So, we are very pleased across the U.S. It seems to be a near even pull throughout.

Tim Conder - Wells Fargo - Analyst

OK, and then the - at what point, you know, if you had the cash build, would you say, hey we've got to really look at the potential share repo, or would you even consider a dividend on an early basis type of thing?

Unidentified Company Representative

Yes, Tim, we actually got a board meeting coming up in November and we are looking at just that subject, so we don't have an immediate answer for you but we have bracketed some ideas and there is different categories, all the way from letting it build on the balance sheet.

We are trying to identify at what point that, you know, it's a trigger point. Share repurchase I think we've quantified that as it relates to expected year end cash amounts, what that might be in terms of improvement on EPS as well as some of the vertical integration opportunities, MNA, either vertically or additional to the current MasterCraft portfolio. So, probably in our next earning call we might have some better direction for you.

Tim Conder - Wells Fargo - Analyst

OK gentlemen, thank you.

Unidentified Company Representative

Thanks Tim.

Operator

Thank you. This concludes today's Q&A session. I would now like to turn the call back over to Mr. Terry McNew for closing remarks.

Terry McNew - MasterCraft - President and Chief Executive Officer

Thank you operator. Once again thanks to everyone for joining us. We kicked off fiscal 2016 with very strong performance and we believe that we are positioned well for the future. We look forward to updating you on our progress and second quarter results in early February. Again, thanks for joining us.

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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