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# EDITED TRANSCRIPT

MCFT - Q2 2017 MCBC Holdings Inc Earnings Call

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



FEBRUARY 09, 2017 / 10:00PM, MCFT - Q2 2017 MCBC Holdings Inc Earnings Call

## CORPORATE PARTICIPANTS

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

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

## CONFERENCE CALL PARTICIPANTS

**Jimmy Baker** *B. Riley & Co. - Analyst*

**Craig Kennison** *Baird - Analyst*

**Joe Altobello** *Raymond James - Analyst*

**Tim Conder** *Wells Fargo Securities - Analyst*

**Rommel Dionisio** *Wunderlich - Analyst*

**Michael Swartz** *SunTrust - Analyst*

**Laura Engel** *Stonegate Capital - Analyst*

**Brian Gaines** *Springhouse Capital - Analyst*

## PRESENTATION

### Operator

Good day, ladies and gentlemen and thank you for standing by. Welcome to the MasterCraft fiscal year 2017 second quarter earnings conference call. At this time all participants are in a listen-only mode to prevent background noise.

(Operator Instructions) We will have a question and answer session later and instructions will follow at that time. And as a reminder, this conference is being record.

Now, I would now like to welcome and turn the call to Mr. Tim Oxley, Chief Financial Officer. Please proceed.

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

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, MasterCraft's 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 2017, 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, February 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 2017 second quarter earnings release includes a reconciliation of these non-GAAP measures to our GAAP results for the second quarter.

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.



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

I'd like to thank everyone for joining us today. As you saw from today's press release, in the first half of 2017 we continued our solid operational performance; delivering gains in gross margins, net income, and earnings per share. As well as improving on our already outstanding working capital management.

We are pleased to see low double-digit growth in retail demand during the first half of our fiscal year. Market reception for our recently released XT20 has been strong and the second quarter launch of the XT21 will allow this series to continue setting the new industry standard in premium features and performance for towboat activities. Lower shipments to retailers in the second quarter of 2017 were in line with our expectations and reflected the timing of production compared to the prior year; as well as efforts to manage pipeline inventories.

For the quarter, we [continued] to grow our gross margin, delivering second quarter gains for the sixth quarter in a row. While international markets continue to present challenges, an industry-wide trend that's not unique to MasterCraft; however, we are beginning to see renewed strength in Canada and parts of the rest of the world. Domestic demand for our boats continues to remain solid. Across the organization, we're intently focused on delivering profitable, sustainable market share growth and driving efficiency in every area of our business; a hallmark of MasterCraft's business model.

During the quarter, we continued to advance our strong product introduction pipeline unveiling the all-new XT21; an agile, mid-sized multipurpose crossover boat. Building on the success of the recently released XT20 model, the XT21 is MasterCraft's latest edition to our new do-everything XT crossover boats that deliver premium comfort and performance at a more affordable price.

The new XT21 is a middleweight crossover boat that is easy to transport and operate and can accommodate a crew of 14. The all-new hull on the XT21 delivers responsive handling with minimum bow rise and improves performance in every on-water activity from large wakes, to endless waves and smooth skiing.

Like all MasterCraft boats, the optional award-winning Gen 2 Surf System has been custom designed for the new hull to create three zones of perfectly sculpted and sizeable curling surf waves. The XT21 also can be outfitted with the revolutionary DockStar Handling System, an innovative flanking rudder system that makes maneuvering in tight spots in crowded marinas a breeze. Moreover, customers have the option of adding our new Cool Feel Vinyl that stays cool to the touch even after extended exposure to direct sunlight, which is an industry first.

In addition to the XT20 and XT21, we look forward to sharing other new models with you later in the calendar year.

Turning back to our operational and financial performance, we delivered a solid fiscal 2017 first half with net sales and EBITDA growth in line with our expectations. And we're optimistic about the future. We remain committed to our five-pronged growth strategy; developing new and innovative products, further penetrating the entry-level and mid-line segment of the performance sport boat category, capturing share from adjacent boating categories, and strengthening our dealer network as well as driving margin expansion through continuous operational excellence.

The operational flywheel is truly turning at MasterCraft and with the continuous improvement culture ingrained at every level of our organization; from the manufacturing floor through engineering to sales and marketing. And as you can see, it's not just talk, it translates to the bottom line every day. This culture is the heart of everything we do here at MasterCraft and is the foundation that will allow us to perform at a best-in-class level through any operating environment we might encounter. This combined commitment to operational excellence and innovation, teamed with our strong diverse product portfolio, position MasterCraft well for fiscal 2017 and beyond.

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



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

From a top line perspective, MasterCraft's net sales decreased \$4.1 million, or 7.4%, to \$51.1 million compared to \$55.2 million for the prior year period. The decrease was due to reduction in the unit sales volume of 65 units, or 9.3%, partially offset by an increase of 2.2% in net sales per unit due to price gains and increased sales of higher content option packages.

Gross profit for the second quarter decreased \$1.1 million, or 7%, to \$14.3 million compared to \$15.4 million in the prior year period due to lower sales volume and overhead absorption associated with lower unit production. Gross margin rose slightly to 27.9% from 27.8% for the prior year period, resulting primarily from increased sales of higher content option packages; which increased average gross profit per unit by 2.6%.

On the expense front, second quarter selling and marketing expense fell \$0.5 million, or 15.2%, to \$2.4 million. General and administrative expense totaled \$4.8 million versus \$9.6 million for the prior year period. The decrease resulted mainly from [a] lower stock-based compensation costs of \$6.6 million, partially offset by higher litigation cost and including the \$0.9 million related to the pending Malibu cases and higher medical insurance cost.

Turning to the bottom line, fiscal second quarter net income totaled \$4 million, up from \$1.9 million in the year earlier quarter. Adjusted net income decreased to \$4.9 million or \$0.26 per share on a pro forma fully diluted weighted average share count of 18.7 million shares. This compares with \$6.2 million, or \$0.33 per share, in the prior year period.

Fiscal second quarter adjusted EBITDA margin declined 150 basis points to 17.6% from 19.1% in the prior year period. Adjusted EBITDA was \$9 million, a 14.5% decrease from \$10.5 million in the prior year period. See the non-GAAP measures in our 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.

I'd also like to highlight the fact that during the second quarter, we completed two [follow-on] offerings for a total of 2,995,000 shares of common stock held by affiliates of Wayzata Investment Partners. Those shares were sold by the company and we did not receive any proceeds from the sale of shares. As a result Wayzata Investment Partners ownership percentage has dropped below 10%.

As Terry mentioned, and as discussed during our previous call, the quarter-over-quarter comparison for fiscal 2017 [will] be choppy due to how our production calendar compares to the production calendar in the previous year's quarter.

Our net sales for the first half of the year were up slightly compared to last year, as we had previously guided. And we reiterate our forecast for net sales growth in the low to mid single digits for fiscal 2017. We also reiterate our expectations for fiscal 2017 adjusted EBITDA margin in the low 19s to reflect the continued strong operating performance we're seeing at MasterCraft. Net sales growth will result in continued growth in net income, EBITDA and adjusted net income despite increased interest expense due to the refinancing completed in the fourth quarter of fiscal 2016.

Before leaving our financials, I'd like to highlight our best in class working capital management. The combined balance of trade receivables and net inventory was \$16.2 million and \$13.8 million at the end of June and December, respectively. Our outstanding cash conversion cycle [days runs] in the low to mid single digits. Superior working capital management affords opportunities to enhance shareholder return in a variety of ways and is a hallmark of a well-managed company. We're consistently performing better than any of our peers in this area.

With that, I would like to echo Terry's comments and reiterate that we are very pleased with our performance and look forward to fiscal 2017. I'll be happy to answer any year-to-date questions during the Q&A.

I'll now turn it back to Terry for our strategy and outlook.

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

MasterCraft has delivered a solid first half of fiscal 2017 and we're optimistic about the future. Across the organization, we remain committed to our five-pronged growth strategy, I outlined earlier.



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For the fiscal year ending June 30, 2017, we are reiterating our expectations for continued growth in net income and adjusted net income. We also expect net sales growth in the low to mid single digits and continued growth in adjusted EBITDA margin with, as Tim indicated, a target in the low 19% range.

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

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Jimmy Baker with B. Riley Inc.

#### Jimmy Baker - B. Riley & Co. - Analyst

Terry, I just wanted to start with the comment that you made about Canada. When you say you're starting to see some signs of strength there, you're not the first that we've heard this from. But, just given the time of year, I'm wondering what specifically you're seeing. Is that showing up at the consumer level at shows? Or is this more dealer optimism and dealers willing to take on a little bit more inventory position heading into the 2017 selling season? And I guess, if you could just tie that into how you're thinking about the dealer pipeline in Canada in particular, moving into the selling season.

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

Right, Jimmy. As you know, at the beginning of model year 2016, when oil started to drop earlier that summer; the change in currency - the Canadian dollar, Tim and I spoke and worked with our Canadian dealers at that time. And we took our commitment to down by 30% to 50% for Canadian dealers at the beginning of fiscal 2016. We just didn't feel like it was going to be productive to throw additional discount money at it. It reminded us what we went through in U.S. back in 2009. Dealer inventory, as we said on several calls, in Canada is very healthy. What we're starting to see now is not only dealers desire to stock more but we're starting to see that with [the shows. Early boat show - not just in Canada, but boat shows up to this time compared to last year at this time are up double digit.

So I think a couple of things are happening in Canada. In particular people are getting used to the level of currency, which is really closer to the long term average for the Canadian dollar. We've got great product. As we mentioned, the XT line is being well-received by dealers and customers alike. So it's a combination of all that. Not just at wholesale; but we're seeing at retail specifically through these early boat shows.

#### Jimmy Baker - B. Riley & Co. - Analyst

Okay, understood. And I was hoping you could also just speak to your domestic distribution networks. So, I think you had a couple of changes in point of distribution this off season. [I] was just hoping if you could give us a little color on the impact, may be if there was any in the quarter here. But really on kind of the full year wholesale activity, and then what that might mean for fiscal 2018.

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

Yes, so we've approached 2017 as bit of a transition year. And we have been upgrading dealers throughout the world, not just domestically. We have a very laser focused on that and work hard with our dealers [that there] are opportunities to constantly upgrade. That does not come without a bit of headwind, but it is a short-term pain, if you will, it's certainly necessary. But we feel it sets us up extremely well for 2018 and beyond. That's why we mentioned in our prepared comments a few times about our confidence in the future.



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

And I would say - Jimmy, this is Tim, the impact on quarter was between 200,000 to 250,000 [as the] discounts to redistribute product from a couple of dealers that we switched out. [That's] some other short term pain that Terry was mentioning, but we're very bullish on new dealers and we're off to good start.

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**Jimmy Baker - B. Riley & Co. - Analyst**

Okay. And then, just lastly, [I] was hoping that you could talk a little bit about what specifically drove - whether in terms of product categories or geographies, what was driving the retail strength for you through the second half of calendar year 2016. the first half of your fiscal year? And then, [I] just had a question on the NXT pricing approach. So a number of dealers we've met with or talked to so far this road show season have been really doing well with this nationally advertised price on the NXT models. Seems to be drawing a customer that maybe didn't think they could otherwise afford a MasterCraft. But I'm just curious from your perspective, if the success of that program has been significant enough that it changes the way you think about approaching that customer?

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

Well, as you know our thesis when we developed the NXTs was to try to reach a bit of a younger demographic; maybe new to water sports, families, those that may be coming out of adjacent categories. And research has shown that the NXTs have been very successful in attracting people who would have probably otherwise bought a used boat and certainly those coming out of sterndrive. We've got objective evidence on that.

The new pricing, I'll let Tim talk about that in a moment. But, as you know, it's new models that sell. So your market share, your new model strength is always going to be a function. If you've done it right and you've got the right product with the right innovation priced right, it's going to be a function of what's coming off your new product development flywheel. So this year, very midline centric; over the last [two] years, we've released three NXTs. So all of those combined really help us penetrate not only the entry level, but the midline with the XT23 released earlier this model year, then the XT20, most recently the XT21. And we're excited about the rest of the releases for this calendar year. So that's definitely helping, especially the XT23, and the XT20's been very well-received. Tim, do you want to fill in on the NXT strategy?

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

Sure. Really, the national advertised price allows us to interact with that more price-sensitive customer. In some cases, as Terry, mentioned [they've] come out with stern drives looking any used boat. And so what seems to happen with that buying behavior, they start off with the \$59,995 price or whatever the price point is and then you can work them up with additional options and features. It's different from the guy that might buy the core product, might buy the 23-foot X23. And [he] starts of [the list] price and then you kind of walk him down. So the buying pattern is a bit different, and this is helping the dealer kind of differentiate between those two customers. You start off with the list price on [a] XT20, you might scare the customer away, even though you end up at the same price from a bottom up approach.

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

Yes, it certainly is. And it's something we work with our dealers to develop this program, it's brought a high level of awareness to consumers and then followed by interest. And the decision points are coming through and you're seeing that in higher sales.

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**Operator**

Craig Kennison with Baird.

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**Craig Kennison** - Baird - Analyst

Thanks for taking my questions as well. I wanted to start with retail. It sounds like for the first six months of the fiscal year, you're up low double digits which is excellent. [I] wonder if you could break that into Q1 and Q2, whether you've seen strength in Q2 in particular?

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

Q1 was stronger for us than Q2. And Q1 is a more significant quarter as a percentage of the annual retail. So when we combine those two on a weighted average, it was up low double digits.

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**Craig Kennison** - Baird - Analyst

And then, maybe on a related note, I'm wondering if the increase in interest rates has affected consumer behavior at all? Maybe in Q2 or in dealer willingness to stock inventory?

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

We haven't seen that at all. Keep in mind that 50% of our customers pay cash for the boat and that transaction was with the dealer. So we don't have great visibility in that. So we're dealing with a higher income consumer and they are less sensitive to interest rate fluctuations than perhaps a blue collar guy might be.

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

And they're coming off such low rates anyway, we believe it will take a while before it cause change in consumer behavior.

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

Yes, I haven't heard anything from dealer or consumer either one.

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**Craig Kennison** - Baird - Analyst

So not affecting dealers either. But does it seem as though dealers seem a little more reluctant to take on inventory because of curtailments or other issues? And I am just wondering, given the strong retail environment and your strong product portfolio, what might cause dealers to be reluctant at all to take [in] inventory?

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

I think, Craig, you are exactly right. The curtailments are significant issues for dealers; that really [stings] when they have to pay those. And obviously they are encouraged to sell the boat before they have to take curtailments. So it's a little bit of change in buying behavior. Every year, the dealers kind of react to what the latest stimulus was. And I think for those that got stuck with some significant curtailments, it's making them little more reluctant to stock. But we have dealer [buy-in] programs that incent certain behaviors. And so we tweak those every year and I'm sure that we'll have some tweaks for fiscal 2018.

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

Craig, the consumers [sentiment], as well as the dealer sentiment post election was nearly immediate. Not a surprise, every industry -- or most every industry's seen that. And we're seeing that carry over into the boat shows. We are hearing from dealers that have had boat shows, "Our boat shows our very strong this year."

**Craig Kennison** - *Baird - Analyst*

And of course, the curtailments really demonstrate good discipline in the channel. So I think we would perceive that as a good thing. But I'm wondering if you could just add a little more color, when does [the] curtailments kick in? And do you have an issue with the age of inventory in any way that has caused that to be a more significant issue?

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

Curtailments kick in - correct me if I'm wrong, Terry, but I think it's after nine months.

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

We do and we cover flooring as part of our program for six months from date of invoice. So if dealers are going to hedge, they'll try to hedge a little bit earlier in the fiscal year on their orders, believe it or not. Because they are looking ahead; the high watermark of inventory in this industry, Tim and I've been in it nearly 60 years combined, is around the end of March, right? It's just normally the retail starts to slow in that fourth quarter [of] the calendar year and starts to pick up a little [slow]. So inventory for just about everybody is pick about March 31st.

And so when they order in July and August, they're looking out with our ordering scheme and saying, "Hey, curtailments could hit as early as January or February." So we're past that already. Retail April 1 to June 30th is 45% to 50% of annual retail. So with our approach this year with production and as you noted, our retail's up low double-digit. We're [in] good position as far as dealer inventory.

**Operator**

Joe Altobello with Raymond James.

**Joe Altobello** - *Raymond James - Analyst*

The first question is just sort of a housekeeping item. You mentioned last quarter that you had five more production days in the quarter. How many fewer production days were in this quarter?

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

It was about the same, about five more in Q1, about five less in Q2. And so that's one reason that we spoke about how choppy our results were going to be this year. You see that result in Q2. And that's one reason, we've also mentioned, how we look on a year-to-date basis through December. So that takes out that choppiness.

**Joe Altobello** - *Raymond James - Analyst*

Okay, so the five fewer days is roughly 5 points of growth on units?





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

Roughly, I mean in rough terms.

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**Joe Altobello** - *Raymond James - Analyst*

Okay. And then, in terms of retail number, I just want to make sure that I'm right here. The low double-digit growth, that's a global number or that's U.S. number?

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

That's a global number.

(Multiple Speakers)

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**Unidentified Company Representative**

[Five] year-to-date.

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**Joe Altobello** - *Raymond James - Analyst*

How does that look U.S. versus international?

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

I don't have that data in front of me. I think the U.S. was up slightly more than that, as I recall.

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**Joe Altobello** - *Raymond James - Analyst*

Okay, but international [was] positive year-to-date?

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

Correct. We mentioned, it's stronger in Canada. We're seeing pockets around the world that are definitely starting to come back and U.S. is currently strong.

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**Joe Altobello** - *Raymond James - Analyst*

Just lastly on Canada, I just want to make sure I heard you correct. Did you guys said that you're seeing dealers starting to build inventories in Canada again?

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

They're definitely more open to wholesale orders and they are seeing it at their initial boat shows and there is more interest in the showroom. So we feel like with our new product - helping the dealers to get down 18 months ago, ahead of the curve, our exposure, our risk at the time with



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units. We didn't just feel like we want to disrupt the [gross] and [nets] by throwing discount money [at it]. We just didn't think that was going to drive the needle and I think we were right, in retrospect. So, the dealers are much more positive, they are seeing more floor traffic, [it's] certainly better boat shows. And their desire to stock at wholesale is greater than it's been in the 18 months.

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

In addition to that, the stabilization of the currency [at] whatever level also encourages the dealer to stock. Because they're not playing games; they're not worried about this boat spoke today, what it's going to be work three months from now? So stabilization of the currency is another aspect that encourages those guys to stock.

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

And certainly oil has come back off its lows of 18 months ago, and it's not 75 but it's certainly above 27, and they are feeling better.

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**Joe Altobello** - *Raymond James - Analyst*

Okay. And just in terms of retail being up low doubles and shipments down two first half, I would have to think that [weeks of] inventory are down pretty significantly amongst your dealers?

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

Yes, you can do the math. I mean, you can see their inventory is improving and we're setting the stage. It's unlikely [that it's] going to take this year's guidance [and] we've already baked that in. But we think we're really setting the stage for strong fiscal 2018.

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

I think [that the] composite our inventory is very healthy, it's [a] newer inventory.

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**Joe Altobello** - *Raymond James - Analyst*

And the channel seems pretty clean as we head into the second half.

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**Operator**

Tim Conder with Wells Fargo Securities.

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**Tim Conder** - *Wells Fargo Securities - Analyst*

Gentlemen, a couple here. We'll stay on the Canada theme; you talked about, Terry, earlier that - and it appeared to be, again, the good decision on hindsight here. Just kind of reached the point where it didn't make sense to throw more FX assistance, whatever you want to call it, at the channel and you just cut things back. How much is that helping year-over-year or that cost that you incurred last year that you don't have this year?



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

I think that's certainly part of the equation. If we hadn't cut back, maybe we'd be going down a second year in a row, but the bottom line is we didn't waste money on our FX discounts as we try to chase after that for that really soft market. It's probably part of the improvement there.

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

Certainly we felt immediately, Tim, 18 months ago as we entered model year 2016 that the price is going to be somewhat inelastic and there just wasn't the demand. I mean, the precipitous drop in the value of the Canadian dollar and - on the heels of the drop in oil, the people - they were just distracted. And we just felt like, why throw that money out there?

Our dealers were very appreciative that we just said, "Listen, we'll take the risk. We'll take the hit, we'll cut the volume down." And so, we didn't disrupt profitability by diluting [net] sales that way. And of course, our operational excellence, we continue to drive bottom line results. It's a real phenomenon and we just felt that it would continue to help us drive the bottom line.

**Tim Conder** - *Wells Fargo Securities - Analyst*

Okay. And then, I mean you quantified I think some things earlier, some of the discounts on redistribution of \$200,000 [to] \$250,000, and that was in the quarter? Or was that year-to-date?

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

That was in the second quarter.

**Tim Conder** - *Wells Fargo Securities - Analyst*

Okay. So, in the quarter or year-to-date, the avoidance of any of FX assistance; [you don't] have any have any quantifications on that?

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

I do not.

**Tim Conder** - *Wells Fargo Securities - Analyst*

Okay. Another thing you called out here was legal expense and medical cost sort of hitting in the SG&A on the lower volume, obviously, in the quarter. What's really driving those medical premiums, specifically this year versus the prior year? And then, on the legal side, any quantification that you can give there on the expense that you're expecting for 2017 and 2018, and does that expense also include any accruals?

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

I'll start with the legal expense. We spent \$1.6 million year-to-date, as a contrast Malibu spent close to \$2 million. We are guiding that we're going to have another \$2 million spent to take us through this fiscal year. We haven't provided guidance on any part of fiscal 2018 yet, and really [its] just going to depend on the outcome of this initial trial to see what happens in October.



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On the medical expense side, as we drill down in there, we have wellness programs. What we're seeing is a growth in prescription drug cost that's very challenging, for instance a cure now for hepatitis C costs \$125,000. The good news is it cures it and someone didn't have to have liver transplant down the road. But that's an example of [the] kind of drug cost that seem to be a bit out of control and just something that if you got the bad luck to have a couple of those guys that's really impactful.

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

Yes. We have some dependants that certainly are impacting medical costs. We're happy to be able to provide it, but it is - we have two or three cases like that. [And] there are other treatments with very high prescription costs as well. They're a bit unique but they are expensive.

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

And we do have a stop-loss, [we're] for self insured up to the first \$90,000. So we do have a stop-loss; we're not totally exposed there, but it certainly is significant.

**Tim Conder** - *Wells Fargo Securities - Analyst*

Okay. And again, just an update on the trial; the first one's in May and then the second is in October is that, correct?

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

That's correct, Tim. The first litigation's around what we call, the 873 patent. That is set for May. And the second one, which we refer to as the 161 patent, is scheduled for October.

**Tim Conder** - *Wells Fargo Securities - Analyst*

Great, okay. And then, one last one, you're talking about - Terry, you mentioned earlier the NXTs and some new product coming on that front. How would you term your mix looking at this fiscal year versus last fiscal year, if you just want to kind broad bucket it into premium versus entry level. I know you've got several; you've got the X series and the NXT and then you've got the XT and so forth. Just in general though, the mix of your business premium versus entry level?

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

As you know, the mix doesn't affect our gross margins; they are non-dilutive [at] gross margin level. So I would characterize 2017 is in the mix of entry level NXTs to our core, similar to what we saw in 2016. But, as I mentioned earlier, your new models sell. And as we deliver to manufacturing from product development more of the XT mid-lines, and going forward into 2018, we know what the cycle plan is for that; that the NXTs will naturally be a lower percentage, we would expect in 2018. Just because we know what the five-year cycle plan's going to be. So I hope that answers your question. But again, the mix is kind of non-denominational to think about it from a gross margin perspective.

**Tim Conder** - *Wells Fargo Securities - Analyst*

But just in those broad buckets, even though the margins equal - [or] is it like - [area of] 30-70, 40-60, anything of entry versus premium?



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

I think the NXT - and keep in mind we only have two models unlike the [Xs], which has five. Three model if you want to count the NXT Global. But it runs between 25% and 30% of our unit sales. [It didn't get that]...

(Multiple Speakers)

**Operator**

Rommel Dionisio with Wunderlich.

**Rommel Dionisio** - *Wunderlich - Analyst*

I just want to drill down a little bit more on gross margins. With that 9% volume decrease, you still managed to maintain gross margins relatively flat, slightly up. Obviously you talk about the higher gross profit [per] unit coming from the higher content option packages. But is there something else going on? I would have thought maybe gross margins might even come down a little bit given that volume decline. You alluded to efficiencies; is there something else with raw materials or more efficient labor, product qualities? If you can just provide little more maybe granularity on why gross margins were able to do so even with that decline in units?

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

Yes, I think with the decline in sales we had in the quarter, to have even a 10 basis point improvement in gross profit margin was one of the more important accomplishments that we achieved. And, again, it's that we get after all kinds of waste. We have continuing improvements in our quality that manifests itself in lower warrant cost. And so it's just really blocking and tackling, as well as the options that we have. We talk about innovation and those are very popular and it drives profitability of the boats up as well.

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

I'll add a little to that, Rommel. You've been here before, you know our operations; we live it every day. So we're driving improvements in yield through current products. But one of our intentional strategies as [we've] developed and released three new programs every year is to learn from that. We have very documented disciplined processes for design, for manufacturing. Feedback from old models to the new models with the target to improve margins on the new model by one to two points through lessons learned; better material selection, continuing to grow the number of common parts. So that's key enabler for our working capital. But it does continue to drive margin improvement and that's why we reiterate, even in our prepared comments, that we feel very comfortable and confident we can continue to drive bottom line growth in almost any environment we counter. It's just part of our culture.

Last year, we implemented in fiscal 2016 20,500 employees suggestions. And this year we're going to be higher. And it was the reason, the key cornerstone, [of] why we won the industry's plant in North America award from IndustryWeek last year.

**Operator**

Mike Swartz with SunTrust.

**Michael Swartz** - *SunTrust - Analyst*

I just wanted to drill down a little bit into your guidance for fiscal 2017; the low to mid single digit revenue growth. Is the outlook there still for flat unit volume? Implying maybe kind of 1% to 2% growth in the back half of the year, is that the way to think about it?



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

No, we don't give specific unit guidance, Mike, as you know. Because we really have structured this system on a [poll] system. So, every week we change mix and we do that. And that's one of the drivers [of] why we can get lower [gross] to net. So if we just focused on revenue growth, as I mention, we upgrade dealers. There is some headwind to that, it can certainly can affect certain markets. There's puts and takes on unit volume, but a lot of things affect that and that's why we focused on revenue. Because the new innovation that we put out in the form of option is a key driver of [ABC] as well.

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

Yes. I will say, Mike, as you look at the balance of the year, we've said we have choppy results And that is going to continue. Our top line growth in quarter three is going to be approaching mid single digit. So you can do the math on the low to mid single digits for the year. So this kind of choppy cadence that we've been talking about will continue on throughout the year and I just wanted to point that out.

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**Michael Swartz** - *SunTrust - Analyst*

Okay, that's very helpful. And then, with the mid single digit in the third quarter, Tim, that's total revenue, not unit volume right?

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

That's total revenue correct.

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**Michael Swartz** - *SunTrust - Analyst*

Okay, that's helpful. And then, just in terms of how to think about market share going forward; maybe what's implied in the guidance. We've got, obviously, kind of the transition you talked about. But retail seems to be pretty strong and kind of repositioning the channel on a wholesale basis. Is there a way to think about just general market share trends we should expect or what you're expecting?

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

Yes, we don't spend a lot of time on that because there is so many unknown variables. We don't know what the competition's going to do. If they overproduce and flush product out, they'll get market share. We've seen that [at] MasterCraft back in 2009. And Tim and I've seen it in our other life when we were at Brunswick Corporation. So we're always about sustainable, profitable market share. We have been pretty consistent in the low 20% now for few years; new product is certainly going to sell. The number we give on retail growth is global number, so obviously market share in U.S. base number. So the improvement that we're seeing in the Canada and in other areas of the world, that won't reflective [in] market share here in the U.S.

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

Yes, [I] will say where we find market share particularly helpful is when we look at it geographically. That was the driver behind [encouraging our Fort Worth team where they] opened [a] second location in Dallas. We continue to look for opportunities like that, where perhaps a satellite location for a strong dealer would be helpful. And so anytime we're below national average, I mean, that represents an opportunity for us. Matter of fact, we call it our lost opportunity [report] we showed to the dealer and how much additional profitability he would produce, if he were to get to national average. I'm bullish on market share, I think we're going to see increases. I can't tell you exactly when, but we're doing the right things in market share is a result of doing a number of things well. And so I think it's going to come.

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

Yes, well said, Tim. And I think, to reiterate on that, Mike, we use the retail registrations for forensics on how to improve dealer health and overall profitability. We're not myopically focused on units and market share by itself. That's the secondary metric. Do those things right, find where we've got holes, find where we're not properly located or we don't have the right training tools, whatever it might be. Then we fix that; the market share comes, profitability comes.

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**Michael Swartz** - *SunTrust - Analyst*

That's helpful. And then just one more from me, a lot of buzz out there, at least the early boat shows, about the new DockStar system. Can you talk about maybe the success you're seeing with that thus far and maybe frame it against other successful option packages you've introduced? And is there any sense of how much that impacted gross margin in the quarter? I know in the December quarter, especially, most manufacturers like to outfit their boats and there is a little bit of incremental option [pull as] they get ready for the boat show seasons. So maybe you can just talk about that?

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

Yes. That is something Tim and I come out - years ago Brunswick [got] inboard and sterndrive and outboard. So we know like customers want that kind of dockability, slow speed, maneuverability that you get with those kind of propulsion packages. The team's been working for approximately two years on this. It is a low cost solution. And as Tim alluded to earlier, when you drive these things, immediately you see the difference. You can backup, left or right; you're not dependent on the prop rotation. And we literally can control the water vector with these flanking rudders.

And if you look at some sport boats, some other brands - sterndrives, those that are trying to get into inboard talk about a bow and stern thruster joystick combination. That technology's been in the world for a long time and it is expensive. That can be up to \$10,000 at retail as an option. [The rudders]...

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

Ours is less than half of that.

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

It's about \$2,000 and it's very, very affordable. It's simple, it's low complexity, as Tim mentioned. You don't have wiring harnesses, you don't have a lot of moving parts that you have points of failure. So we're very, very pleased with that. And the early adopters and our dealers picked that up early, actually in Q1. I think they got stocked with that well; they feel good; we saw that kind of taper off a little bit in Q2. But the product is out there, it's in their showrooms; it's at the boat shows, as you mentioned, Mike. And we expect that to pick up now as we get into probably Q3 and Q4.

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

And keep in mind that it is just one of the three most important innovations during the year. We have to cool touch vinyl which decreases the [ambient] temperature of vinyl that's in the sun by approximately 15 degrees Fahrenheit; very significant. We're the industry first on that, so we're seeing uptake on that....

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### Unidentified Participant

[Best for us]...

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

Right. And we have a new power tower that's actually less expensive and more functional than the previous one. So we continue to have a lot of innovation. I wish I could tell you exactly how much the profitability that [it's] driving. I know it's significant, but I don't have that quantified.

### Operator

Laura Engel with Stonegate Capital.

### Laura Engel - Stonegate Capital - Analyst

Thanks for taking my questions. I wondered, kind of back to the international front, you talked a lot about Canada. But just referencing kind of the international challenges quote in the release, anything else other than just basic economics? Any other logistical or such with dealers, establishing networks that you want to talk about or was it principally what we have discussed thus far?

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

I think it's primarily the headwind of the foreign currency. But I will say that there is not the same - the post-election positiveness that we see in the U.S., it's not happening in Europe. Terry and I both at the [Disrial] boat show. Positive boat show, a lot of positive experiment over there. But they don't have this tailwind, I think, of consumer confidence. And so, I think that that kind of holds them back a little bit in addition to the currency.

### Laura Engel - Stonegate Capital - Analyst

Okay, and then longer term, past years, it's seems to have been the piece of pie, it's been hovering around 9% or 10%. Say next one to three years, what do you see just high levels, as far as how much that segment can grow as a portion of your business?

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

Yes, it's really just a function of how fast since the U.S., North American market is such a large part of our business as that continues even at a lower percentage. But it is larger than the rest of the world. So [to] kind of characterized it in Europe, to Tim's point, it's still a little bit sideways. I think they're trying to find a bottom, it kind of feels like they are behind Canada, by maybe 12 months. But I think there is some positive starting to show up. We've added a few points in Europe and upgraded some dealers recently we think will - in Europe that will position us extremely well for 2018. And the rest of the world, there is definitely signs that other regions are starting to rebound as well.

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

But, what we might see because of the strength of - not only U.S., now Canada coming on, we may see the rest of world growing but at a lower pace than North America. So we may see this 8% or 9% continue on or could even shrink a little bit.





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

Yes, that's right. Because if the U.S. and North America grows at, I'm just going to say low to mid single digit percentage increase, it's such a large number that can actually outpace. Even though the other areas might have a mid to high single-digit, [it's] just [the] math.

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**Laura Engel** - *Stonegate Capital - Analyst*

Right. Okay. Well, I appreciate you taking my questions. And I'll get back in the queue. Thanks.

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**Operator**

And our next question comes from the line of Brian Gaines with Springhouse Capital. Please go ahead.

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**Brian Gaines** - *Springhouse Capital - Analyst*

Hey, guys. Most are asked and answered. But, just to clarify, again, when you talk about double-digit growth that's revenue, and not units, when you talk about the retail demand?

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

When we talk about retail, we always talk in units, because we don't have data that shows what the dealers were selling it for. So, we had double-digit growth in retail units in the first six months of our fiscal year.

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**Brian Gaines** - *Springhouse Capital - Analyst*

Got it, okay. Thanks. And then just to clarify, international at this point, I think in the past you kind of said, Canada is I guess high single digits, maybe even up to 10, rest of world is around 10, is that still accurate?

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

I've got to take another look at that. I mean, we are in a dynamic part of the year where the production mix changes. But Canada is going to be I think over 10% this coming year, and I am expecting the rest of world outside North America to be 8% or 9%. So, the very important Western Canadian boat shows happen later on this quarter. So, we will have a little better sense of Canada. But right now, I think Canada is going to grow over 10% and the rest of world is going to hover down 8% or 9% and it could even be better than that.

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**Brian Gaines** - *Springhouse Capital - Analyst*

And within that 8 or 9, is the UK is the biggest piece?

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

UK has been our largest dealer outside North America, but I tell you, the Brexit hurt those guys a bit combined with the devaluation of the British pound sterling. So, I'm not sure who is going to be number one over there now, we're doing a good in Switzerland and Austria. A number of our European countries have mature distribution; they are doing a good job for us.

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**Operator**

And our next question is follow-up from Tim Conder with Wells Fargo Securities.

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**Tim Conder** - *Wells Fargo Securities - Analyst*

Just a quick one here, we'll revert back to something that is very unpredictable but just want to get your thoughts on and it's cold weather. Clearly, El Niño helped California in this past year, and then we had a quite a bit of rain and a lot of progress on the drought conditions over the winter here so far. So, what early indicators look for you from the California and the areas impacted there by drought? And then, conversely, we've seen a little bit a more drought conditions start to emerge, sort of near neck of the woods where your factor is little bit part of the southeast in that. So just thoughts from weather perspective, and I'm wondering if you can isolate that?

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

Northern California, the dealers are reporting some of the likes up there 130% of capacity. So, though that is definitely return. The LA boat show recently was -- there were Monsoon rains outside during the show. So, that's helpful. We actually saw a dry period here in Tennessee for our long period of time, but that's ended about two, three months ago. We really have got a lot of rain recently. So, that's very helpful. And as we mentioned earlier, we haven't had any dealers that I know of that has concerns about drought; it is actually very positive.

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

I think both the Atlanta Boat Show, the Birmingham Boat Show, those are two areas that had drought in a pretty bad way, both of those boat shows were very positive. So, based on boat show results, I'm not seeing -- and I think may be, the drought gets a lot of prevalent obviously in the summer. I think some of the winter rains have dissipated that significantly. (Technical Difficulty) So, it certainly was dry in southeast towards the summer and early fall but that seems to have subside.

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**Operator**

And ladies and gentlemen, this concludes our Q&A session for today. I will turn the call to Mr. Terry McNew for any final remarks.

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

Thank you, Operator. Once again, thanks to everybody for joining us. We believe that our success has positioned us well for fiscal 2017 and beyond as we mentioned. We look forward to updating you on our progress and third quarter results in May. Thanks again.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program and you may all disconnect. Have a wonderful evening.

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