

## **Brunswick Earnings Conference Call Q4 and full-year, 2014 – January 29, 2015**

### *Bruce Byots – Vice President, Corporate and Investor Relations*

Good morning, and thank you for joining us. On the call this morning is Dusty McCoy, Brunswick's Chairman and CEO, and Bill Metzger, CFO. Also with us is Mark Schwabero, President and Chief Operating Officer.

Before we begin with our prepared remarks, I would like to remind everyone that during this call our comments will include certain forward-looking statements about future results. Please keep in mind that our actual results could differ materially from these expectations.

For the details on the factors to consider, please refer to our recent SEC filings and today's press release. All of these documents are available on our website at Brunswick.com.

During our presentation, we are using certain non-GAAP financial information. Reconciliations of GAAP to non-GAAP financial measures are provided in this presentation, as well as in the supplemental information sections of the consolidated financial statements accompanying today's results.

I would also like to remind you that the figures in this presentation reflect continuing operations only, unless otherwise noted.

On July 17, 2014, the Company announced: 1) the signing of an agreement to sell its Retail Bowling business, and 2) its intention to sell its Bowling Products business. On Sept. 18, 2014, the sale of the Retail Bowling business was completed.

As a result, the historical and future results of these businesses are reported as discontinued operations and the historical and future results of the Billiards business, which remains with the Company, are reflected in the Company's Fitness segment. Therefore, for all periods in this presentation, all figures and outlook statements incorporate these changes and reflect continuing operations only, unless otherwise noted.

I would now like to turn the call over to Dusty.

### *Dusty McCoy – Chairman and CEO*

Thank you, Bruce and good morning everyone. I'll start with an overview of full-year results.

Revenue in 2014 increased 7 percent. We experienced growth in outboard boats and engines, marine parts and accessories, fitness equipment and fiberglass sterndrive/inboard boats, which was partially offset by a decline in sterndrive/inboard engines.

Our gross margin increased by 60 basis points compared to the prior year - - driven by volume leverage, favorable warranty comparisons and new products, partially offset by costs associated with production and new product ramp-ups.

Operating expenses increased by 4 percent, as we continue to invest in numerous strategic initiatives at increasing levels. 2014 operating expense was approximately 17.6 percent of sales - - in-line with our guidance.

Adjusted operating earnings increased by 21 percent versus prior year.

Net interest expense was reduced by \$11.8 million.

Adjusted pretax earnings increased by 32 percent, which is slightly above our guidance range.

Diluted EPS, as adjusted, of \$2.42, reflected a \$0.06 benefit from the recently extended U.S. R&D credit. Excluding the benefit from the credit, EPS - - as adjusted, was \$2.36 – one cent above the high-end of our guidance.

Our 2014 revenue performance benefited from recent investments in growth initiatives with several new products being introduced into the marketplace along with increases in production rates and capacity. Sales growth also reflects parts and accessories acquisitions made during the year.

The Boat and Fitness segments reported top-line improvements of 10 percent and 7 percent, respectively. Mercury's sales were up 5 percent.

From a geographic perspective, consolidated U.S. sales increased by 8 percent.

Sales to Europe increased by 14 percent, due mostly to strong performance by our marine segments, as well as incremental revenues from acquisitions.

Rest-of-World sales declined by one percent versus the prior-year period, due to weakness in sales of boats and engines, mostly offset by gains in engine parts and accessories and Fitness.

In summary, consolidated sales outside the U.S. increased by 4 percent for the full-year.

For the full-year, adjusted operating earnings were \$360.6 million, an increase of \$62.3 million compared to 2013. The Engine and Boat segments each contributed about \$25 million to this increase.

Our operating margin, excluding charges, increased by 110 basis points to 9.4 percent. Operating leverage for the full-year was 26 percent. As we stated at our November 2013 investor day, we expected leverage to exceed our 3-year target of 20 to 25 percent in 2014. A key contributor to our 2014 leverage was the benefit achieved from favorable warranty experience, and related adjustments.

In 2014, adjusted pretax earnings increased by \$82.1 million, or 32 percent. About three-quarters of the improvement was derived from the increase in operating earnings.

Diluted EPS from continuing operations, as adjusted, for the full-year equaled \$2.42 per share. This compares to net earnings, as adjusted, of \$2.47 per share in the prior year.

If you apply a 32.5 percent tax rate to 2013, our 2014 EPS, as adjusted, would reflect a 30 percent growth rate.

All three of our segments reported strong, top-line growth in the fourth quarter. Sales in our combined Marine segments increased by 15 percent, while our Fitness segment increased by 8 percent.

From a geographic perspective, consolidated U.S. sales increased by 18 percent.

Sales to Europe increased by 27 percent, due to strong growth in all three segments. Excluding the impact of the Whale acquisition, sales to Europe increased by 22 percent.

Rest-of-World sales decreased by 2 percent versus the prior-year period. Canadian sales of our marine businesses were the largest contributor to the quarterly decline.

In summary, combined sales outside the U.S. increased by 7 percent.

Adjusted operating earnings were \$42.7 million for the quarter, an increase of \$28.8 million compared to 2013.

Operating margins, excluding charges, increased by 280 basis points to 4.5 percent.

The increase in our operating margin reflects the impact of strong sales growth. Operating earnings includes the effect of an increase in operating expenses due to the funding of our numerous strategic initiatives.

Diluted EPS from continuing operations, as adjusted, for the quarter equaled \$0.33 per share, reflecting a 26 cent increase. Bill will provide more detail on the non-cash charges that were made during the quarter related to pensions and an equity investment.

I will provide our perspective on the global marine market.

The U.S. market in 2014 performed slightly better than our initial expectations. Based on preliminary SSI data, the U.S. powerboat industry grew approximately 5 percent in 2014. This follows a 3.5 percent gain in 2013.

As a result, the U.S. powerboat industry now approximates 166 thousand units. If we apply 2014's growth rate to 2015 and 2016, the U.S. market would be above the high-end of our 2016 base case of 175,000 to 180,000 units.

Although the U.S. marine market is slightly ahead of our base case assumptions, due to weakness in various non-U.S. markets, 2014 global marine retail unit growth was slightly below the low-end of our annual growth expectations of 3 to 5 percent.

Given our assumption of a continuation of a sub-three percent global GDP growth, we anticipate 2015 U.S. industry growth rates to be comparable with 2014. Our plan reflects the rest-of-world's markets being flat.

Let me provide some additional color on marine markets outside the United States.

Although we are experiencing excellent top-line growth in Europe due to factors that Bill will elaborate on, we believe the majority of the European marine marketplace remains very challenging. We believe overall retail demand was about flat, but this varies by country and region. There appeared to be some modest recovery in Southern Europe from a very low base, while Northern and Central Europe were flat to down slightly. Eastern Europe, particularly Russia, was down significantly. In 2015, we are planning for Europe to be flat with Eastern European markets remaining depressed. We are closely watching ECB monetary policy, elections, currency and instability in Eastern Europe.

In Canada, an unusually cold and wet spring led to a late start to the boating season and currency variability caused some consumers to delay or defer purchases. We believe retail demand in Canada was down mid-to-high single digits in 2014. In 2015, we are planning for the market to be flat - - reflecting normal weather patterns, but continued currency disruption.

In South America, weaker than expected economic conditions were the primary factor that caused lower market demand. We believe this region was down mid-to-high single digits, with Brazil down more significantly. In 2015, we are planning for these markets to be about flat, with Brazil starting to stabilize. Economic growth, inflation and currency will be important drivers.

Finally, in Asia Pacific we believe the market was flat to up slightly, and are planning for low-single digit growth in 2015.

In summary, we are planning for markets in 2015 to be flat in most non-U.S. markets.

Now, I'll turn the call over to Bill for a closer look at our segment results and financials.

Bill Metzger – CFO

Thanks Dusty. I'll start with the Marine Engine segment, where sales were up 10 percent in the quarter. From a geographic perspective, sales in the U.S. were up 13 percent, reflecting an increase in outboard engines and parts and accessories, which was partially offset by the impact of lower sterndrive/inboard engine revenues. For the full-year, U.S. sales were up 5 percent.

Sales to Mercury's European customers increased by approximately 31 percent for the quarter, as growth was experienced in all product categories. Growth in parts and accessories benefited from the recent Whale acquisition and growth initiatives, while stronger outboard performance

included benefits from new products and improved conditions in certain countries. For the full-year, sales to Europe were up 14 percent.

Rest-of-World sales decreased by one percent, as these regions benefited from gains in parts and accessories, while engine revenues were down compared to prior year. For the full-year, sales to Rest-of-World were also down one percent.

On a product category basis, the outboard engine business reported solid overall sales growth in the fourth quarter of 2014, which included Mercury's new 75, 90 and 115hp FourStrokes. These new engines, which are built with the same architecture as the popular 150hp FourStroke, have also been well-received by OEMs and consumers.

Our outlook for the outboard engine business continues to reflect favorable retail demand in most markets and boat categories.

On the sterndrive side, Mercury's award winning and recently launched 4.5 liter 250hp purpose-built engine is receiving very positive feedback from OEMs. Sterndrive engine sales, however, continued to be affected by unfavorable global retail demand trends. Diesel engine sales were up modestly during 2014.

Mercury's parts and accessories businesses delivered strong sales growth during the quarter, with gains in most major markets.

Revenue benefited from recent acquisitions, new product launches and market share gains. The acquisitions of Whale and Bell Recreational Products Group accounted for approximately \$13 million, or 3 percentage points of Mercury's overall revenue growth rate in the quarter.

We again reported record sales in the fourth quarter at Land 'N' Sea and Attwood.

Mercury's operating earnings increased by 75 percent compared to last year's fourth quarter. Operating margins were at 6.8 percent, 250 basis points higher than the prior year quarter.

The improvement in operating earnings included the benefit from higher sales, recently launched outboard products and favorable warranty experience.

For the full-year, the Engine segment's operating margin was 14.1 percent, an increase of 50 basis points versus the prior year.

Mercury's full-year operating earnings exceeded \$300 million for the first time in its 75-year history.

In our Boat segment, fourth quarter revenues increased by 23 percent. This included strong growth in sales of outboard boats, as well as in fiberglass sterndrive/inboard boats.

In the U.S., which represented over two-thirds of the segment, sales increased 37 percent. For the full-year, U.S. sales were up 15 percent.

In the fourth quarter, European sales increased by approximately \$5 million, or 31 percent versus the prior year. This performance resulted from the introduction of new products, including

larger, higher priced products by our European outboard boat brands. For the full-year, European sales were up 32 percent. We expect our European sales growth to moderate in 2015 - - anticipating a growth rate to be modestly above our market assumptions

Rest-of-World sales decreased by 5 percent in the quarter, which reflected the weaker demand in Canada and South America referred to by Dusty earlier in the call. For 2014, Rest-of-World sales decreased 7 percent.

In the fourth quarter, Brunswick's global retail unit sales increased by 14 percent compared to prior year; global wholesale unit shipments increased by 6 percent. This compares to the Boat group dollar sales increase of 23 percent, as the segment also benefited from higher average selling prices resulting from a favorable shift in mix across most of its boat lines.

For the full-year, global retail unit sales increased by 2 percent compared to prior year, while global wholesale unit shipments were up 1 percent.

Regarding our pipelines, dealers ended the year with 35 weeks of boats-on-hand measured on a trailing 12-month retail basis, which is comparable to the prior year level.

Pipelines for aluminum and fiberglass outboard products are up compared to last year, due to an expanded distribution network, new product introductions and weaker-than-expected retail demand in Canada. Fiberglass sterndrive/inboard pipelines are down versus the prior year.

Our current pipeline levels are appropriate, given our growth expectations in the various boat categories and we continue to be comfortable with these overall levels.

The Boat segment's fourth quarter adjusted operating earnings improved by \$12.2 million, or 76 percent, when compared to the prior year.

This improvement resulted from higher sales, including several new product introductions. Operating performance in the quarter did include increasing costs associated with new product integrations, capacity expansions and production ramp-up.

The segment's year-over-year earnings improvement also reflected the absence of costs related to pipeline reduction of large fiberglass boats completed in Q4, 2013.

For the full-year, the segment's operating margin, excluding charges, was 1.6 percent, a 220 basis point improvement versus 2013.

Sales at Life Fitness increased by 8 percent for the quarter, resulting from growth in the U.S. to health clubs, hospitality, education and local and federal government customers, as well as modest sales growth in international markets, particularly in Europe.

For the full-year, U.S. sales were up 9 percent, while European and Rest-of-World sales were up 4 percent and 7 percent, respectively.

The segment continued to benefit from new product introductions in all regions, with this quarter representing its ninth consecutive quarter of year-over-year revenue growth.

Segment operating earnings in the quarter increased 11 percent, as the impact from higher sales was partially offset by continued increases in growth initiative investments.

For the year, the segment's operating margin finished at 15.0 percent, comparable to last year's margin.

Moving now to foreign exchange - - in the fourth quarter, foreign currency had a higher than expected unfavorable impact on changes in total consolidated sales of slightly under 2 percent, and operating earnings of approximately \$3 million. For the full-year 2014 versus 2013 comparisons, exchange rates had a minimal impact on overall sales and operating earnings.

We do, however, expect a more significant impact on our sales and earnings in 2015. On the revenue side, just over approximately 20 percent of our consolidated sales is transacted in a currency other than the dollar. The unfavorable translation impact on these sales caused by changes in exchange rates is estimated to be approximately 2 1/2 percent of consolidated sales. Changes in currency will also lower operating earnings by approximately 7 percent, or \$25 million. This amount considers the impact of currency translation on both sales and costs transacted in a currency other than the dollar, as well as the impact of hedges. The sales and operating earnings impacts reflect exchange rates in line with current levels, and reflect significant changes in the last couple months.

During the fourth quarter of 2014, our GAAP earnings also reflected two non-cash charges totaling approximately \$48 million:

In the fourth quarter, we reported a \$27.9 million charge pertaining to lump sum settlement payments made to certain pension plan participants. This item was one we discussed but did not quantify on previous earnings calls. We are planning a second lump sum payout in 2015 and would expect a comparable charge in Q4, which would not be included in our, as adjusted, EPS reported earnings.

The second item is a non-recurring impairment charge of \$20.2 million pertaining to an impairment of our minority investment in a European-based boat business, reflecting the continued performance challenges faced by that business.

Regarding our tax provision:

Our effective book tax rate, as adjusted, was 22.3 percent and 32.5 percent for the quarter and full-year, respectively. Our effective book tax rate for 2014, now includes the benefit from the extension of the U.S. R&D tax credit, which lowered the rate by approximately 1.5 percent for the year.

Our 2015 guidance, however, does not assume that this credit will extend into 2015, therefore our as adjusted effective tax rate is 34.0 percent.

Our estimated effective cash tax rate for 2015 reflects a mid-teen percent level.

Turning to a review of our full-year cash flow statement. Cash provided by continuing operating activities was \$235.3 million, an increase of \$67.3 million versus the prior year.

Net increases in our primary working capital accounts totaled approximately \$67 million. Excluding the impact of acquisitions, the biggest changes occurred in:

- Accounts and notes receivable, which increased by \$24 million,
- Inventory increased by \$57 million,
- Accrued expenses increased by \$6 million, and
- Accounts payable increased by \$13 million.

Excess tax benefits from share-based compensation activity adversely affected our cash from operations in 2013 by about \$37 million and \$8 million in 2014. This item resulted primarily from stock options exercised in both periods and is derived from the difference between the expense recorded for book purposes and the expense reflected in the Company's tax return. GAAP requires that these excess tax benefits be reclassified to financing activities and not included in operating cash flow. Normally, these benefits would lower taxes paid and the reclassification would have no impact on free cash flow.

However, because of the Company's cash tax position, these excess tax benefits did not materially benefit our taxes paid in either period. Consequently, this activity had a negative impact on free cash flow in both 2013 and 2014.

Regarding our pension:

We ended 2014 with an unfunded obligation of \$310 million - - representing a \$55 million increase from prior year levels. The main drivers for this increase are the adoption of new mortality tables, reflecting longer life expectancies, and lower discount rates, which more than offset contributions and favorable investment experience.

For 2015, our plan reflects \$70 million to \$75 million of cash contributions, which includes an estimated amount that will be used to fund the second part of our lump sum buyouts - - a significant portion of the full-year contributions will be funded in the first quarter to maximize return and plan expense benefits.

Although our unfunded obligation increased, our pension expense in 2015 is expected to be lower by \$2 million, due primarily to actions taken to fund and de-risk our pension plans.

Full-year capital spending was in line with the prior year at approximately \$125 million, which included investments in new products in our marine and fitness businesses, as well as capacity expansion projects.

Total year-to-date free cash flow amounted to \$116 million, which is twice the amount reported in the prior year.

Our business units continue to remain focused on generating strong free cash flow, which will allow us to continue to fund future investments in growth and enhance shareholder returns.



At year-end, cash and marketable securities totaled \$636 million. The increase of \$267 million from year-end 2013 reflects the net proceeds received from the sale of the Retail Bowling business, and free cash flow from continuing operations, partially offset by \$42 million of spending for both acquisitions and dividends along with share repurchases of approximately \$20 million.

Let me conclude with some comments on certain items that will impact our P&L and cash flow for 2015.

Our estimate for depreciation and amortization is approximately \$90 million.

We expect our 2015 pension expense to be approximately \$13 million.

Net interest expense is expected to be about \$26 million.

Combined equity earnings and other income are anticipated to be comparable to prior year.

And, we expect our diluted shares outstanding to be approximately 94 million to 95 million. The reduction in average shares outstanding reflects the execution of our \$200 million share repurchase program, partially offset by stock compensation plan activity. We expect to systematically complete this program over approximately a two-year period.

On the cash flow side, the Company plans to make cash contributions to its defined benefit pension plans of approximately \$70 million to \$75 million in 2015, as described earlier.

Our current plan anticipates working capital changes to result in a modest usage of cash of \$30 million to \$50 million, and capital expenditures of approximately 4 percent of sales, with a substantial portion directed at growth and profit enhancing projects, including meeting capacity expansion requirements in each of our segments.

Despite higher investment spending levels and a modest usage of cash for working capital, we plan to generate strong free cash flow for the full-year in the range of \$150 million to \$170 million.

I will now turn the call back to Dusty to continue our outlook comments.

*Dusty McCoy – Chairman and CEO*

Thanks, Bill. Our operating plans and assumptions for 2015 remain fairly consistent with those we communicated at our 2013 investor day meeting. We continue to target 2015 to be another year of strong earnings growth with outstanding cash flow generation.

Our plan reflects approximately 6 percent to 8 percent sales growth, which includes benefits from the success of our new products and the continuation of the growth demonstrated in the U.S. in 2014, partially offset by weakness in certain international markets, as well as the unfavorable impact from foreign exchange. Our guidance does not include any additional acquisitions made in 2015.

We anticipate a slight improvement in gross margin levels, which assumes an absence of favorable warranty adjustments achieved in 2014, and our ongoing focus on managing cost of goods sold through initiatives such as Lean Six Sigma, and supply chain and manufacturing efficiencies.

As a result of ongoing growth investments, full-year operating expenses, will increase, but as a percentage of sales, are expected to be lower than 2014 levels - - approximately 17.0 to 17.2 percent.

As a result, our pretax earnings should continue to demonstrate strong growth of 15 percent to 20 percent. Our 2015 EPS, as adjusted, is projected to be in the range of \$2.70 to \$2.85.

An early look at 2015 first-half indicates continued strong top-line growth - - forecasted in the high-single to low-double-digit range. While we are planning for improvements in operating margins for the full-year, first-half operating margins will be flat to down compared to the same period in 2014. This reflects foreign exchange headwinds, the absence of 2014 favorable warranty adjustments, and continued increases in investments to support our strategic objectives, where the growth rate of these investments is heavily weighted to the first-half of 2015.

In addition to these items, our product success has introduced additional costs and inefficiencies in the first-half, as we open and expand plant capacity to meet demand, continue to introduce a significant number of new products into production in each of our segments, and ramp-up production as our sales continue to experience significant growth. These costs and inefficiencies will abate in the second-half, and our second-half operating margins will improve. We remain committed to deploying our resources to address the headwinds through additional manufacturing initiatives using Lean Six Sigma, and commodity cost opportunities.

The 2015 financial targets for our operating segments also remain fairly consistent with our 3-year plan.

Our overall plan reflects continued revenue and operating earnings growth in our Marine Engine segment.

Specifically, we are planning for revenue growth in the mid-single digit range, with a modest improvement in operating margins, despite currency headwinds and the continued negative impact on operating leverage from acquisitions.

We will continue to make significant investments at Mercury.

Looking at our Boat segment, our plan assumes that we continue to successfully execute our large fiberglass boat strategy, which is a key part of an increasing number of new products that will be shipped into the market.

Our plan also reflects solid growth of outboard boats under 28 feet throughout the year and, therefore, influences our overall average sales price. As a result, increases in average-sale-prices will be at lower rate of growth versus 2014.

We are targeting 2015 annual revenue growth in the low double-digit range, with year-over-year improvement in the segment's operating margin comparable to 2014.

In our Fitness segment, our plan is based on continued revenue growth and maintaining strong operating margins. In 2015, we continue to target revenue growth in mid-single to high-single digit range.

We will continue to make significant investments at Life Fitness - - aggressively leveraging innovation to achieve competitive differentiation in its products and services, which should continue to enable market share growth and create business opportunities beyond its core business model.

And, although Life Fitness' margins could decline slightly in 2015 as a result of these investments, our plan continues to reflect very healthy margins in this business.

Our capital strategy for 2015 remains consistent with what we described to you on our last call. Over the next two years, we plan to:

- Maintain strong cash and liquidity positions.
- Deploy capital to strengthen our Marine and Fitness segments. We will do this both organically by continued investment through capital expenditures, R&D and SG&A. This commitment is an important foundation in our effort to drive an aggressive pace of new product introduction, which is imperative in our overall goal to grow revenue and market share. We will also be actively pursuing acquisition opportunities, with an initial focus on Mercury's parts and accessories businesses.
- We will continue to grow our fitness business by expanding into new product categories, and growing distribution in customer segments and regions we serve throughout the world. In addition, we are currently exploring and piloting certain adjacency opportunities in both the fitness equipment and health and wellness sectors, as well as evaluating acquisitions.

Finally, we plan to execute our pension de-risking plans, as well as return cash to shareholders through a balanced approach that includes dividends and share repurchases.

Thank you and now we will take your questions.