

Brunswick Earnings Conference Call Q3, 2014 – October 23, 2014

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.

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, of this year, 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.

Starting with the third quarter of 2014, the historical and future results of these businesses are now reported as discontinued operations and the historical and future results of the Billiards business, which remains with the Company, are now 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.

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 our third quarter results.

Revenue in the quarter increased 13 percent. We experienced double-digit growth in outboard boats and engines, marine parts and accessories, fiberglass sterndrive/inboard boats and fitness equipment, which was partially offset by a decline in sterndrive engines.

Our gross margin increased by 20 basis points compared to the prior year.

Operating expenses increased by one percent, as we continue to invest in numerous strategic initiatives at increasing levels.

Adjusted operating earnings increased by 45 percent versus prior year.

Net interest expense was reduced by \$1.2 million.

As a result, adjusted pretax earnings increased by 56 percent, while diluted EPS, as adjusted, increased by \$0.05 to \$0.63, reflecting a higher 2014 effective tax rate.

All three of our segments reported double-digit, top-line growth in the quarter. Sales in our combined Marine segments increased by 14 percent, while our Fitness segment increased by 11 percent.

From a geographic perspective, consolidated U.S. sales increased by 15 percent.

Sales to Europe increased by 19 percent, due to growth in marine sales. Excluding the impact of the Whale acquisition, sales to Europe increased by 13 percent.

Rest-of-World sales increased by 6 percent versus the prior-year period, due to gains in Fitness.

In summary, combined sales outside of the U.S. increased by 10 percent.

In the nine months, the Fitness and Boat segments reported top-line improvements of 7 percent and 6 percent, respectively. Mercury's year-to-date sales were up 4 percent. These year-to-date growth rates are now at or approaching our full-year guidance targets.

From a geographic perspective, consolidated U.S. sales increased by 6 percent.

Sales to Europe increased by 10 percent, due to growth in marine sales.

Rest-of-World sales declined by one percent versus the prior-year period, due to weakness in marine markets, mostly offset by gains in our Fitness segment.

In summary, consolidated sales outside of the U.S. increased by 3 percent for the nine months.

Adjusted operating earnings were \$94.6 million for the quarter, an increase of \$29.3 million compared to 2013.

Operating margins, excluding charges, increased by 220 basis points to 10.1 percent.

The increase in our operating margin includes the impact of the strong sales growth combined with the slight increase in operating expenses of one percent.

During the third quarter, operating expenses continue to reflect investment in numerous strategic initiatives and continued emphasis on expense control. In addition, corporate expenses decreased when compared with the prior year due to lower variable compensation expense, as well as favorable including mark-to-market adjustments on certain equity-based awards.

We are forecasting that operating expenses in the fourth quarter will increase by a low single-digit percentage, when compared to the prior year.

For the first nine months, adjusted operating earnings were \$317.9 million, an increase of \$33.5 million compared to 2013.

Our operating margin, excluding charges, increased by 70 basis points to 11.0 percent.

As a result of the solid improvement in our adjusted operating earnings, combined with lower net interest expense and higher other income, adjusted pretax earnings in the third quarter increased by approximately \$32 million, or 56 percent.

For the nine months, adjusted pretax earnings increased by \$48.6 million, or 19 percent.

Diluted EPS from continuing operations, as adjusted, for the quarter equaled \$0.63 per share, reflecting a 9 percent increase.

As a reminder, our reported EPS for 2014 reflects a significant year-over-year increase in our effective book tax rate.

Diluted EPS from continuing operations, as adjusted, for the first nine months equaled \$2.09 per share. This compares to net earnings, as adjusted, of \$2.41 per share in the prior year.

If you apply a 34 percent tax rate to 2013, our 2014 EPS, as adjusted would reflect a 18 percent growth rate.

Before I turn the call over to Bill, I'll take a moment to provide some perspectives on the global marine market.

The U.S. market is unfolding generally consistent with our annual expectations of solid growth in outboard boat and engine products, as well as in parts and accessories, partially offset by fiberglass sterndrive weakness.

Year-to-date, the U.S. powerboat industry is up approximately 4 1/2 percent. On a rolling 12-month basis the market has improved by about 4.7 percent. In the fiberglass sterndrive/inboard boat category, which also affects sterndrive/inboard engine production, modest year-to-date unit growth in boats greater than 30 feet is being more than offset by declines in boats under 30 feet.

Certain international markets, however, have experienced declines in retail sales, specifically in Canada and South America. 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. In South America, weaker than expected economic conditions are the primary factor causing lower market demand in Brazil, Argentina and Venezuela. 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 is very challenging.

In total, year-to-date global marine retail demand growth is below our annual expectations.

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 11 percent in the quarter. From a geographic perspective, sales in the U.S. were up 9 percent, reflecting an increase in outboard engines and parts and accessories, which was partially offset by the impact of lower sterndrive/inboard engine revenues.

Sales to Mercury's European customers increased by approximately \$17 million, or 35 percent, as growth was experienced in outboard engines and parts and accessories. Growth in parts and accessories benefited from the recent Whale acquisition and growth initiatives, while stronger outboard performance included benefits from new products, improved conditions in the Nordic region and sales timing. For the nine months, sales to Europe are up 10 percent.

Rest-of-World sales increased by 2 percent, as these regions benefited from gains in outboard engines as well as parts and accessories, while sterndrive/inboard engine revenues were down compared to prior year. Latin America was the only major region to experience declines in overall sales.

On a product category basis, the outboard engine business reported solid overall sales growth in the third 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 are up slightly year-to-date.

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

Revenue benefited from recent acquisitions, new product launches and market share gains. The acquisitions of Whale and Bell Recreational Products Group accounted for approximately \$15 million, or 3 percentage points of Mercury's overall revenue growth rate in the quarter.

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

Mercury's operating earnings increased by 24 percent compared to last year's third quarter. Operating margins were at 16.5 percent, 180 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.

In our Boat segment, third quarter revenues increased by 22 percent. This included balanced 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 31 percent.

European sales increased by approximately \$4 million, or 36 percent versus the prior year. This performance resulted from the introduction of larger, higher priced products by our European outboard boat brands.

Rest-of-World sales decreased by 2 percent, which reflected the weaker demand in Canada and South America referred to by Dusty earlier in the call.

In the third quarter, Brunswick's global retail unit sales increased by 7 percent compared to prior year; global wholesale unit shipments also increased by 7 percent. This compares to the Boat group dollar sales increase of 22 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 nine months, global retail unit sales increased by one percent compared to prior year, while global wholesale unit shipments were flat. Our plan assumes that the wholesale unit growth rate for the full-year will be consistent with our retail unit growth rate.

Regarding our pipelines, dealers ended the quarter with 27 weeks of boats-on-hand measured on a trailing 12-month retail basis, which is one week higher than the prior year level.

Pipelines for aluminum and fiberglass outboard products are up compared to the 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 annual growth expectations in the various boat categories and we continue to be comfortable with these overall levels.

The Boat segment's third quarter adjusted operating earnings improved by \$8.2 million, or 57 percent, when compared to the prior year.

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

Sales at Life Fitness increased by 11 percent resulting from growth in the U.S. to health clubs, hospitality and local and federal government customers, as well as net sales growth in international markets, especially in the Middle East, Africa and Latin America.

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

Segment operating earnings in the quarter increased slightly, as the impact from higher sales was partially offset by a lower gross margin percent and continued increases in growth initiative investments.

In the quarter, foreign currency had minimal impact on changes in total consolidated sales and operating earnings.

For the full-year 2014 versus 2013 comparisons, we currently estimate that exchange rates will also have a minimal impact on sales and operating earnings. We do, however, expect a slight unfavorable impact on Q4.

These comparisons include the impact of our hedge programs and assume that rates remain consistent with current levels for the remainder of the year.

Now, I would like to provide some brief comments on our tax provision:

Our effective book tax rate, as adjusted, was slightly below 34 percent for both the quarter and nine month period. Our plan assumes that the as adjusted rate for the full year is consistent with the year-to-date rate.

Our estimated effective cash tax rate continues to reflect a low double-digit percent level.

I also would like to note that our effective book tax rates for 2014 exclude any potential benefit from an extension of the U.S. R&D tax credit.

Turning to a review of our year-to-date cash flow statement. Cash provided by continuing operating activities was \$122.7 million, a decrease of \$17.8 million versus the prior year. Pension contributions were a factor in the year-over-year decline due to planned increases and timing of contributions.

In addition, net increases in our primary working capital accounts totaled approximately \$151 million. Excluding acquisitions, the biggest changes occurred in:

- Accounts and notes receivable, which increased by \$42 million,
- Inventory increased by \$74 million,
- Accrued expenses decreased by \$55 million, and
- Accounts payable increased by \$22 million.

To date, working capital movements have been unfavorable versus the prior year due mostly to changes in inventory, which resulted from new product introductions, along with higher sales and production levels.

For the remainder of the year, we anticipate that working capital changes will be favorable versus 2013 and end the full-year with a net usage of \$40 million to \$60 million.

Total year-to-date free cash flow amounted to \$49 million versus approximately \$69 million in the prior year, a difference of about \$20 million.

Year-to-date capital spending was in line with the prior year at approximately \$80 million, which included investments in new products in our marine and fitness businesses, as well as capacity expansion projects.

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.

Cash and marketable securities totaled \$597 million at the end of the quarter. The increase of \$228 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, which were partially offset by acquisitions and dividends during the nine months of \$42 million and \$30 million, respectively.

Let me conclude with some comments on certain items that will impact our P&L and cash flow for 2014.

Our estimate for depreciation and amortization is approximately \$80 million.

We expect our 2014 pension expense to be approximately \$15 million, which is a decrease of \$4 million from 2013.

Net interest expense is expected to be in the range of \$28 million to \$29 million.

We anticipate that our restructuring charges will be between \$4 million and \$5 million in 2014.

And, we expect our diluted shares outstanding to be approximately 95 million to 95.5 million. As you are aware, we announced on Wednesday that our Board had authorized a share repurchase program of \$200 million. We expect to systematically complete this program over approximately a two-year period, beginning in the fourth quarter. Consequently, there will be no meaningful impact on Q4 and full-year shares outstanding.

On the cash flow side, the Company plans to make cash contributions to its defined benefit pension plans of approximately \$75 million in 2014. This includes an estimated amount which will be used to fund planned lump sum settlement payments to certain participants. Our restructuring charge estimate and adjusted earnings per share do not include the impact of any pension related settlement charges associated with this payout plan.

Our plan reflects capital expenditures of approximately \$140 million, 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 \$110 million to \$135 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 the full-year remain fairly consistent with those we communicated throughout the year, after adjusting for the bowling divestitures. We

continue to target 2014 to be another year of strong earnings growth with outstanding cash flow generation.

Our plan reflects approximately 6 percent sales growth, which includes benefits from the success of our new products and the continuation of the growth demonstrated in the U.S. thus far in 2014, as well as mixed performance in international markets.

We continue to anticipate a solid improvement in gross margin levels.

As a result of ongoing growth investments, full-year operating expenses, adjusted for the divestitures, will increase, but as a percentage of sales, are expected to be lower than 2013 levels - - approximately 17.6 percent.

As a result, our pretax earnings should continue to demonstrate strong growth of 28 percent to 31 percent. On our last earnings call we established our 2014 EPS, as adjusted, guidance of \$2.25 to \$2.35. Today, we are updating our guidance to a range of \$2.30 to \$2.35.

The full-year financial targets for our three operating segments remain largely unchanged.

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

Specifically, we are planning for full-year revenue growth in the mid-single digit range, with a solid improvement in operating margins.

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 will help to generate growth in the fourth quarter and is a key part of an increasing number of new products that will be shipped into the market. As a result, we should continue to see the benefit from a more favorable sales mix leading to higher average-sale-prices.

Continued strong performance in outboard boats and contributions from our Brazil operations should also benefit the segment's growth in the final quarter.

As a result, we are targeting 2014 annual revenue growth in the high-single digit range with a solid improvement in operating earnings.

Further, we anticipate a significant year-over-year improvement in operating losses during the fourth quarter; but, the segment is expected to have a modest seasonal operating loss. Our full-year plan reflects the segment achieving solid profitability.

In our Fitness segment, our plan is based on continued revenue growth and maintaining strong operating margins. Our 2014 and 3-year plans are both targeting 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 2014 as a result of these investments, our plan continues to reflect very healthy margins in this business.

In closing, I want to comment on our current capital strategy. We will continue to maintain strong cash and liquidity positions. This strong foundation, combined with continued execution of our growth plan, should enable us to regain an investment grade credit rating.

Our top priority will be to deploy capital to strengthen our Marine and Fitness segments.

We will do this both organically through continued investment in 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. As we told you, we have already completed two such acquisitions. In doing so, we have executed about 20 percent of the plan thus far and anticipate executing additional transactions over the next several years.

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 pursuing 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. Yesterday's announced authorization for the repurchase of stock reflects our confidence in the successful execution of our operating and financial plans, as well as in our future performance.

Thank you and now we will take your questions.