



**Malibu Boats Inc. (NASDAQ: MBUU) Date: 04-Jan-2020**  
**Closing Price: \$61.81**

### **Executive Summary**

- **Malibu Boats is the leading manufacturer of premium recreational powerboats:** Malibu Boats produces and sells performance sport boats, sterndrive boats and outboard boats under four brands – Malibu, Axis, Cobalt, and Pursuit.
- **Malibu Boats produces a high return on equity and a high pre-tax return on capital employed:** The business has no credit risk and minimal inventory carrying costs which lowers working capital requirements. In addition, they have been able to earn excellent returns while employing little debt.
- **The recreational powerboat industry has major tailwinds:** Historically low dealer inventory is set to benefit the industry demand in the short-term. Over the long-term, as generation X and millennials begin to age, they will begin to partake in boating activities more frequently.
- **Malibu Boat's has company-specific tailwinds:** The fragmented outboard market provides Malibu with an opportunity to expand its product offerings via acquisitions and product line expansions.
- **Malibu Boats has a deep economic moat that has allowed it to take market share away from its competitors:** Malibu owns strong brands that allow it to sell its products at a premium in comparison to its competitors. Furthermore, Malibu's patented Surf Gate technology differentiates Malibu's boats from its competitors and is the reason why they are able to dominate the PSB category and win customers over.
- **Malibu Boats is a growing company selling at a significant discount to its intrinsic value**

## **Industry Description**

A recreational powerboat is a consumer discretionary product that is purchased by customers at a dealership. Retail prices for boats can range anywhere from \$5,000 to \$1,000,000+. Customers on average are affluent individuals who belong to middle and upper-middle class families. In addition, the average boat owner is 58 years old and the average first-time boat owner is 46 years old.

The recreational powerboat industry consists of the following categories: outboard, sterndrive, performance sport boat, jet boat, and cruisers. For calendar year 2019, the breakdown of the recreational powerboat market is as follows:

Calendar Year 2019		
Recreational Powerboat Category	Unit Sales	Retail Sales (In Millions)
Outboard	172,700	\$ 7,656.00
Sterndrive	10,100	\$ 883.00
Performance sport boat	11,100	\$ 1,232.00
Jet boat	5,900	\$ 289.00
Cruisers	1,600	\$ 1,269.00
	201,400	\$ 11,329.00

Source: Company Filings

Each category above presents a different story.

### **Performance Sport Boats & Jet Boats**

The performance sport boat (PSB) and jet boat category consists of boats with inboard propulsion systems that are primarily used for watersports activities and high-speed driving. Over the past several years, these two categories are among one of the fastest growing in the industry. The PSB unit sales have had a 6-year CAGR of 10.49% and PSB retail sales have had a 6-year CAGR of 17.42%. Jet boats have experienced a similar rise in popularity. Jet boat unit sales have had a 6-year CAGR of 11.93% and jet boat retail sales have had a 6-year CAGR of 16.94%. The PSB market is an oligopoly with Malibu Boats, Correct Craft and Mastercraft being the 3 largest manufacturers. Combined they control approximately 75% of the market segment. The jet boat market is virtually a monopoly with Yamaha controlling that niche market.

### **Outboard Boats**

The largest category in terms of retail sales is the outboard market. These are boats whose propulsion systems are attached to the stern of the boat. These boats are known to be more fuel efficient and easier to maintain resulting in a lower cost of ownership for buyers. This has led to an increase in popularity in recent years with outboard unit sales growing at a 6-year CAGR of 4.22% and outboard retail sales growing at a 6-year CAGR of 17.15%. Additionally, unlike the PSB market, the outboard market is highly fragmented. This category consists of many subcategories with the largest being the pontoon market and the fishing market. Each one of these subcategories are then further divided into hundreds of manufacturers. For example, if you were to look at the pontoon market and the deck & saltwater fishing market, the market breakdown is as follows:

### Pontoon Market Share

By Brand	Market Share	Y/Y Unit Growth (%)	Y/Y Market Share Change
Bennington	18.5%	3.9%	0.9%
Tracker	18.4%	4.0%	0.9%
Avalon/Tahoe Pontoons	6.8%	6.5%	0.5%
Godfrey	6.1%	(9.5)%	(0.6)%
Forest River Marine	5.7%	(9.8)%	(0.5)%
Sylvan	5.3%	(5.3)%	(0.2)%
Harris	4.8%	(5.0)%	(0.2)%
<b>Crest</b>	<b>3.6%</b>	<b>9.1%</b>	<b>0.3%</b>
Qwest-Gillgetter	2.7%	(3.7)%	(0.1)%
Manitou	2.6%	(7.0)%	(0.2)%
Starcraft	2.6%	7.7%	0.2%
Misty Harbor	2.5%	(8.5)%	(0.2)%
All others	20.4%	(5.1)%	(0.9)%
Total	n/a	(1.1)%	n/a

Source: Mastercraft's Raymond James Presentation

### Deck & Saltwater Fish Market Share

By Brand	Market Share	Y/Y Unit Growth (%)	Y/Y Market Share Change
Boston Whaler	6.9%	(0.8)%	0.1%
Carolina Skiff	6.6%	(6.5)%	(0.3)%
Robalo	6.0%	2.6%	0.3%
Sea Hunt Boats	5.7%	(4.0)%	(0.1)%
Key West	5.2%	(5.4)%	(0.2)%
<b>Nautic Star</b>	<b>5.1%</b>	<b>(4.6)%</b>	<b>(0.1)%</b>
Hurricane	3.9%	(5.0)%	(0.1)%
Mako	3.8%	(1.6)%	0.0%
Sportsman	3.7%	(11.7)%	(0.4)%
Tidewater	3.4%	8.8%	0.3%
Grady-White	3.1%	4.7%	0.2%
All others	47.9%	(1.8)%	(2.3)%
Total	n/a	-2.3%	n/a

Source: Mastercraft's Raymond James Presentation

## Sterndrive Boats & Cruisers

The sterndrive category consists of boats whose propulsion system combines the use of an outboard drive unit with an inboard engine. Sterndrives tend to be easier to handle and has a larger swim platform. Cruisers are larger boats that are used to relax, entertain, and cruise. Both the sterndrive and cruiser categories are the only segments of the industry that have not been growing over the past several years. Over the past 6 years, sterndrive retail sales have had a CAGR of -0.22% and sterndrive unit sales have had a CAGR of -6.48%. Additionally, over the past 2 years, sterndrive retail sales have had a CAGR of 1.98% and sterndrive unit sales have had a CAGR of -6.28%. Cruisers show a similar statistic with unit sales declining by a CAGR of -8.23%. The sterndrive market is also relatively consolidated. According to Statistical Survey's Inc, the top 5 sterndrive manufacturers account for approximately 63% of the sterndrive market.

## Suppliers

The largest cost associated with building a boat is its engine. It is estimated that approximately 85% of all engines sold in the US are outboard engines. In addition, the marine outboard engine industry is a duopoly with Yamaha controlling approximately 40% of the industry and Brunswick controlling 30%. As such, marine engine suppliers have power over boat manufacturers.

## Company Description

Malibu Boats is a manufacturer and marketer of premium recreational boats. It consists of four brands: Malibu, Axis, Cobalt and Pursuit. The Malibu and Axis brands are responsible for manufacturing performance sport boats, and together they control approximately 32.7% of the PSB market which is 10% greater than the 2<sup>nd</sup> largest manufacturer. The Cobalt brand manufactures sterndrive, cruisers and outboard boats, and has a 17.4% market share within the sterndrive market. Pursuit operates in the saltwater outboard fishing market and has the number two market share position within this category. As of calendar year 2019, Pursuit has an 18.8% market share.

Malibu Boats also holds 36 patents, with the most notable being the Integrated Surf Platform which includes the patented Surf Gate and Power Wedge technology. These patents benefit wakesurfers by allowing them to create larger and more customisable waves without having to move people around the boat.

### **The Economics of the Business**

Malibu Boats operates in an industry where dealerships purchase inventory from manufacturers using cash obtained from the bank. In other words, sales occur on a cash-basis, which in turn indicates that there is virtually no credit risk. Malibu Boats also manufactures products based on specific orders from dealers. Thus, there is little to no inventory carrying costs.

Malibu Boats is also pursuing a vertical integration strategy. Specifically, as of 2019, they are marinizing the engines used in the Malibu and Axis boats. By doing so, they are able to partially mitigate the supplier power that Yamaha and Brunswick have in the marine engine industry.

Additionally, Malibu Boats operates in an industry that does not require a lot of leverage. Historically, Malibu has taken on debt only when making acquisitions, repurchasing common stock, or repurchasing units from LLC unit holders. The business also does not have large capital requirements. Approximately 20% of cash flows from operations are used to maintain current facilities. The remaining 80% can be used to expand facilities and to grow the business organically or inorganically.

As a result of the above characteristics, Malibu Boats is able to generate high pre-tax returns on invested capital and high returns on equity. Malibu generated \$83.7M of pre-tax income on \$102.8M of capital employed in the business. This ensures that capital is not tied up in the business and is used efficiently. In addition, they are able to generate these returns using conservative levels of debt.

### **Business Tailwinds**

Malibu Boats has industry and company-specific tailwinds.

#### **Industry Prospects**

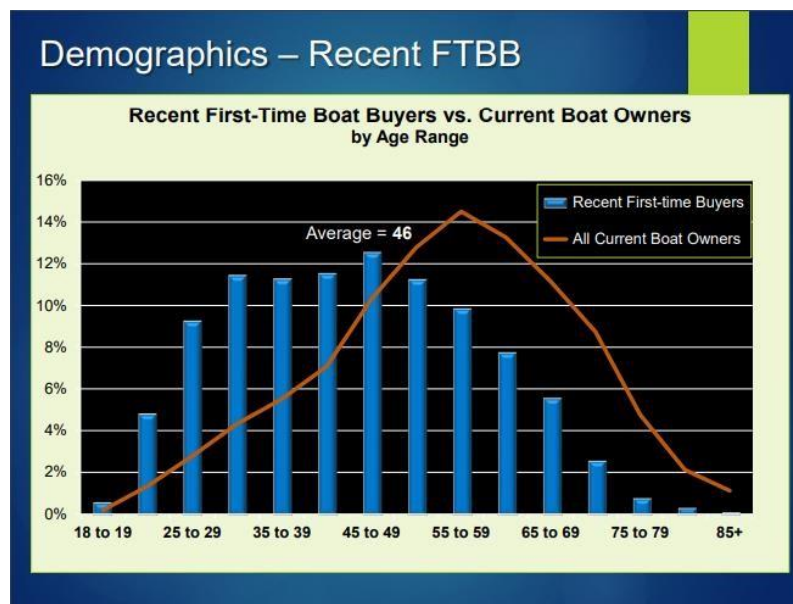
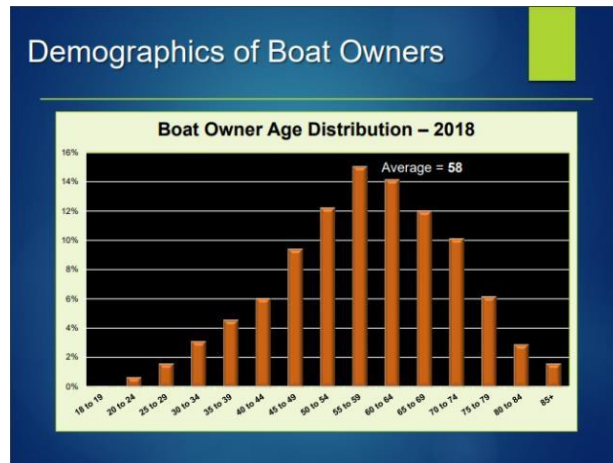
The recreational boating industry has both short-term and long-term tailwinds. Regarding shortterm prospects, COVID-19 has had an interesting effect on dealerships. Due to the coronavirus, people were looking for a recreational activity to partake in with their friends and families. Boating was one of the popular options as it provided groups with a safe and social way to interact and spend time. This surge in demand, in manufacturer plant shutdowns, led to low inventory levels at dealerships. For the two largest public recreational boat dealerships, inventory levels are nearly half of historical averages. Manufacturers and dealerships are estimating that inventory levels won't be normalized until mid to late 2021.

Furthermore, there are currently two long-term demographic tailwinds for the industry:

1. The Baby Boomer Generation: Majority of boat owners (approximately 40%+) fall within this segment of the population. As baby boomers enter retirement, they tend to spend more of their leisure time doing recreational activities. This will benefit the boating industry in the medium to long-term.

Source: NMMA State of the Recreational Boating Industry Presentation

2. **Generation X and Millennials:** These two segments of the population are known to be more family and experience oriented. They tend to partake in more social activities than previous generations, and are more likely to sacrifice their savings for experiences. As they start to overcome the affordability barrier that comes with boat ownership, the industry will begin to benefit due to the unique social experience that boating is able to provide. In fact, the industry is beginning to experience some of the benefits currently. The average age of a first-time boat buyer is 46, which indicates that the gen X population is already beginning to purchase boats. Over the next 20 years, the industry will likely see more purchases from the gen X and millennial population.



Source: NMMA State of the Recreational Boating Industry Presentation

## Company Prospects

In addition to a positive industry outlook, Malibu Boats has the following company-specific tailwinds:

1. **Fragmented Outboard Market:** With the recent acquisition of Pursuit and Cobalt, Malibu Boats has shown their intentions of competing within the outboard market. As of FY2020, Malibu Boats generates sales of approximately \$150M from the outboard market. This only accounts for 2% of the total outboard retail sales as of calendar year 2019. Going forward, they will seek to expand within the highly fragmented outboard market through acquisitions and product line expansions.
2. **Consumer Trends:** Current consumer buying habits are benefiting premium boat manufacturers. Within Brunswick Corp's annual report, they have outlined how

consumers are purchasing premium brands with higher horsepower engines and more content, as opposed to purchasing value brands. This benefits Malibu as they primarily focus on the premium segment of the recreational boating industry.

3. **International Growth:** Approximately 93% of Malibu's revenue comes from North America. In the medium to long-term, they will be able to increase their international presence in the European and Asian-Pacific market.
4. **Dealer Base Expansion:** Malibu's largest dealer, OneWater Marine, represents approximately 15% of Malibu's revenues. According to their S1 filings, currently they operate 60 stores in 11 states. Over the next few years, they will be acquiring 6 to 8 additional dealerships, and will be looking to expand into other geographic segments such as the Midwest and Western United States. The increase in OneWater stores will directly benefit Malibu Boats as it will expand their dealer base and allow them to sell their products in more stores across the US.
5. **Marinization Program:** Malibu now produces its own engines for its Axis and Malibu brands. For the Cobalt and Pursuit brands, they have an agreement with Yamaha to purchase outboard engines from them until June 30, 2023. Once the agreement expires, I suspect that they will begin to produce their own engines for those brands which will allow Malibu Boats to overcome the duopoly of the marine engine market and realize a larger gross margin on their boats.

### Competitive Advantage

Malibu Boats has two competitive advantages.

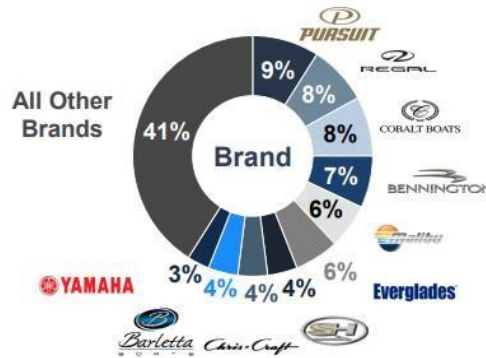
#### **Brand Name**

Amongst boaters, Malibu Boats is known for producing high-quality, premium boats. When visiting boating forums such as the Malibu Crew (<https://www.themalibucrew.com/>), there is clear indication that there is a degree of brand loyalty for Malibu and its boats. In addition, from discussions I have had with boat dealers and boaters, majority have stated that you can't go wrong by purchasing a Malibu boat. This brand name has also allowed Malibu to increase its prices over the years, as well as charge a higher average retail price in comparison to its competitors.

Manufacturer	Brand	Retail Price Range	Description
Malibu Boats	Malibu	\$60K - \$210K	PSB
	Axis	\$65K - \$115K	PSB
	Cobalt	\$60K - \$450K	Sterndrive and Outboard Boats
	Pursuit	\$80K - \$800K	Saltwater Outboard Fishing Boats
MasterCraft Boats	MasterCraft	\$75K - \$190K	PSB
	NauticStar	\$35K - \$300K	Outboard Fishing Boats
	Crest	\$30K - \$160K	Outboard Pontoon Boats
	Aviara	\$345K - \$670K	Sterndrive and Outboard Day Boats
Marine Products Corporation	Robalo	\$23K - \$275K	Outboard Fishing Boats
	Chaparral	\$34K - \$415K	Sterndrive and Outboard Boats

Furthermore, when looking at the product breakdown for OneWater Marine, 3 out of the top 5 best selling brands, or 23% of OneWater's total product portfolio, are Malibu owned (i.e. Pursuit, Cobalt, and Malibu/Axis). This is a testament to Malibu's brand and popularity.





Source: OneWater Investor Presentation

## Surf Gate Patented Technology

Malibu's second competitive advantage is its Surf Gate technology. This patented technology is the reason why wakesurfers love Malibu's products and why Malibu is able to dominate the PSB category. In addition, this technology has been battle tested and defended in court which indicates the strength of Malibu's patent.

## Management

I believe Jack D. Springer (CEO of Malibu Boats) is a terrific and competent manager. His track record over the past decade has been amazing. During his tenure as CEO, he has taken Malibu's market share in the PSB category from 23.4% in 2009 to 32.7% in 2019. He has also been able to grow Malibu's sales from less than \$100 million to approximately \$650 million, whilst maintaining efficiency. Additionally, Jack has shown his competency through his management of this pandemic. Despite the shutdown in production, the company has been able to generate net income in every quarter of FY2020.

Furthermore, Jack has made two acquisitions during his tenure as CEO. Both were bolt-on acquisitions at cheap prices. When Malibu purchased Cobalt in July of 2017, it had paid \$130,525,000 for a company that generated \$141,893,000 in sales the prior year (i.e. < 1x sales). When Malibu purchased Pursuit in October of 2018, it paid \$100,073,000 for a company that generated \$123,906,000 in sales the prior year (i.e. < 1x sales). Moreover, unlike many other CEOs, Jack doesn't just buyback shares in an attempt to inflate EPS. Rather, he only repurchases shares on the rare occasion the stock is cheap. For example, no shares were repurchased by the company from FY2017 onwards until March of 2020 (i.e. the coronavirus crash). At that point, the company repurchased \$13.8 million of shares at an average price of \$28.53 (i.e. 9x FY2019 earnings). This goes to show that Jack is a competent capital allocator which bodes well for shareholders.

Lastly, Jack is incentivized to perform well over the long-term. During the coronavirus crash, he purchased an additional \$772,000 of stock at an average price of \$25.72. He now owns approximately 1.2% of class A shares in addition to his long-term stock options that expire in 2023 and 2024. As such, he is well incentivized to focus on the long-term success of the company.