

WESTPEAK RESEARCH ASSOCIATION

Malibu Boats, Inc. (NASDAQ: MBUU)

Consumer Discretionary – Boat Manufacturing

Torque and Tailwind

March 15, 2018

Malibu Boats is a manufacturer and marketer of inboard, sterndrive and outboard powerboats, as well as boat accessories and trailers. Malibu Boats was founded in 1982 and distributes its products through a global dealer network.

Thesis

Malibu Boats has been able to attain and maintain the market leading position in the performance sport boat industry, by leveraging a series of competitive advantages. These include intellectual property, economies of scale, dealer relations, vertical integration and product mix. As a result, the company was able to generate higher margins than competitors, consistently beat earnings estimates, tap into international markets, intensify marketing efforts and acquire Cobalt Boats in 2017. We believe that investors are failing to appreciate how company-specific and industry-wide trends will synergize to expand cash flow generation.

Favorable Macro Trends and Economic Moats

Increasing consumer incomes, greater recreation expenditure and new product demand from emerging markets are macroeconomic factors we believe will strengthen Malibu Boats' revenue generation in the future. In addition, we expect acquisition synergies, the development of innovative product features and the integration of upstream processes to increase margins. In combination, the company will be able to continue reporting positive earnings surprises and therefore earnings reports can catalyze the stock price to its intrinsic value.

Valuation

Through our discounted cash flow and comparable companies' analysis, we arrived at a target share price of \$40.00. With 20% upside, we issue a **buy** rating for the Malibu Boats stock.

Analyst: Marius Schneider, BCom. '19
contact@westpeakresearch.com

Equity Research	U.S.
Price Target	US\$ 40.00
Rating	Buy
Share Price (March 15. Close)	US\$ 33.34
Total Return	20%

Key Statistics	
52 Week H/L	\$36.81/\$20.52
Market Capitalization	\$684M
Average Daily Trading Volume	0.20M
Net Debt	\$90M
Enterprise Value	\$758M
Net Debt/EBITDA	1.9x
Diluted Shares Outstanding	20.4M
Free Float	98%
Dividend Yield	0%

WestPeak's Forecast			
	2018E	2019E	2020E
Revenue	\$453M	\$480M	\$498M
EBITDA	\$76M	\$96M	\$100M
Net Income	\$28M	\$55M	\$57M
EPS	\$1.38	\$2.73	\$2.85
P/E	15.2x	15.7x	13.3x
EV/EBITDA	10.2x	10.4x	9.3x



Business Overview

Malibu Boats is the leading manufacturer of recreational powerboats in the U.S. The company's product offering is comprised of 34 boat models including performance sport boats, sterndrive and outboard boats across three product brands. The company is vertically integrated along the design, manufacturing and marketing of its boats and is connected to a vast dealership network through which it distributes its boats. In addition to boats, the company also sells trailers and boat accessories. Malibu Boats focuses on providing performance, luxury and comfort with its boats and facilitating water sports such as wakeboarding, water skiing and water surfing. The company has patented an assortment of innovations and boat accessories, which it licenses out to competitors for royalty fees. Malibu Boats has manufacturing facilities in the U.S. and Australia but sells its products internationally.

Product Lines

Malibu

Malibu is the company's flagship brand and currently includes eleven models. Since its launch in 1982, the brand's focus has been on performance, comfort and convenience. All Malibu models are equipped with inboard motors and the models range from 20 to 25 feet in length and from \$50,000 to \$180,000 in retail price. The brand includes three product series: the Wakesetter, the Response, and the M series. All three series offer luxurious designs and innovative features, culminating the brand's premium boat experience.



Source: Company Website (Wakesetter 20VTX)

Axis Wake

Axis boats was launched in 2009 with the purpose of providing a lower cost alternative to the Malibu product line. Axis includes five models that range 20 to 24 feet in length. With retail prices ranging from \$50,000 to \$95,000, the Axis product line is more focussed on simplicity than luxury. Nevertheless, the models offer high quality and high performance, and can be upgraded with new features, such as Surf Gate. Affordability and the product line's entry-level nature, makes Axis boats more appealing to a price-sensitive and younger demographic.



Source: Company Website (Axis Wake A20)

Cobalt

Cobalt Boats was founded in 1968 and acquired by Malibu Boats in July 2017 for \$130.5 million. The Cobalt brand offers 18 outboard and sterndrive models that range 20 to 40 feet in length. The acquisition introduces Malibu Boats to the outboard and sterndrive market and thus extends the company's product mix beyond the inboard performance boat market. Similar to the Malibu brand, Cobalt focusses on luxury, comfort and performance with its models. With retail prices ranging from \$50,000 to \$700,000, the brand's product mix includes entry-level, mid-range and super premium models. Namely, the brand's five product lines are: the Gateway Series, the R series, the A series, the SD-SC series, and the WSS/Surf Series.



Source: Company Website (Cobalt 200S)

Product Accessories

Integrated Surf Platform

Malibu Boats has developed an integrated control system for its boats that connects a combination of features to optimize the wakeboarding or surfing experience. The Integrated Surf Platform (ISP) allows users to modify the wake's size, position and shape and is controllable through a touchscreen-operated command center. Depending on the boat model's features, the electronic dashboard lets users control Malibu Boats' patented Surf Gate, Power Wedge, Surf Band and G3/G4 Towers. These technologies work together through the ISP and allow Malibu Boats to offer the best wakeboarding and surfing experience.

Electronic Dashboard Controls

MaliView, Malibu Touch Command and Command Center are various dashboard versions that Malibu Boats has employed into its boat models. The latest version is the Command Center and it is included in various models since 2015. It features a 12-inch touchscreen, wireless connectivity and complete control over the boat's technological innovations. Not only can the system be used to control Surf Gate and Power Wedge, it can also be used to control navigation, play music and create lighting through the tower.

Hard Tank Ballast System

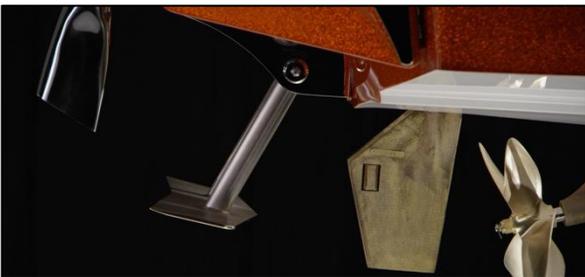
The hard tank ballast system involves tanks at the bottom of the boat, which can be filled with water to increase the weight of the boat. Depending on the model, the tanks can simulate up to 2360 pounds of ballast, which leads to water displacement and a change in the angle at which the wake is generated. As a result, the wake's size can be significantly increased. The level at which the tanks are filled can be controlled through the ISP and the adjustment takes place within a few minutes.



Source: Company Website

Manual Wedge and Power Wedge

All Malibu and Axis boats come equipped with either a Manual Wedge or a Power Wedge, both of which are patented by the company. As the image illustrates below, this technology represents a wedge that can be deployed at the transom of the boat. The Power Wedge can be controlled by the ISP and is exclusively available for the Malibu product line. The Power Wedge II is the latest version and can be deployed in seven different positions to displace up to 1,500 pounds of water. Upon deployment, the wedge quickly increases the boat's lift, steepening the angle at which the wake is created and thus increasing the arc of the wake.



Source: Company Website

Surf Gate

Surf Gate is one of Malibu Boats' revolutionary innovations, as it replaces the need to fill or empty ballast tanks in order to control the size and shape of wakes. Surf Gate represents a series of panels attached to the side of the boat, that work well in conjunction with the Power Wedge to customize the exact size, shape and position of the wake. Not only is the deployment of Surf Gate controllable through the ISP, its effect is almost immediate. Surf Gate was patented in 2013 and received the Watersports Industry Association Innovation of the Year award in the same year. Surf Gate is an optional feature that can be installed on all Malibu and Axis boats.



Source: Company Website

Surf Band

Surf Band is a patented wristband that surfers can use to remotely control the wake, music volume and boat speed. This technology eliminates the need for hand-signalling between the surfer and the driver. Since the Surf Band can control the Surf Gate, the Power Wedge and the speed of the boat, the surfer has complete control over the wake conditions that shape the surfing experience.



Source: Company Website

Swim Step

Swim Step is a patented innovation developed by, and available exclusively for Cobalt boats. Swim Step is a retractable step that can be deployed at the rear of the boat to facilitate easy entry into the boat out of the water. The technology eliminates the hassle of re-entering the boat out of the water and therefore significantly improves the comfort of the boating experience.



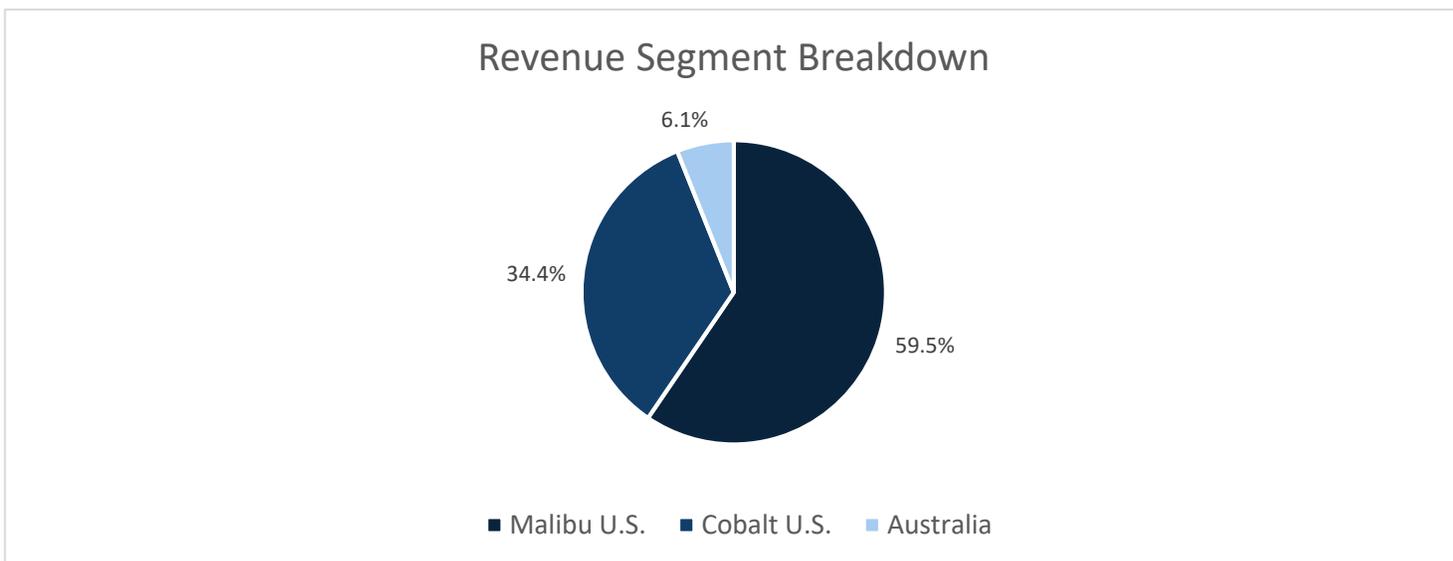
Source: Company Website

TruWave

TruWave is Cobalt's patent-pending boat accessory that has a similar function to Malibu's Surf Gate. The technology involves surf tabs on both sides of the boat whose position can be adjusted to customize the size, position and shape of the wake. TruWave is put into effect within seconds of deployment and eliminates the need to adjust ballast.

Revenue Segmentation

Malibu Boats breaks down its revenue segments by geography and brand. Prior to the acquisition of Cobalt Boats in July 2017, the company only reported its U.S. and its Australia segments, which represented the respective locations of manufacturing facilities. Both segments involved the sale of the company's Malibu and Axis brands. For the quarter ended September 30, 2017 Malibu Boats added a new segment for Cobalt Boats and its manufacturing facility is also in the U.S. The Australia segment serves the Australian and New Zealand markets, and the U.S. segments serve North America, South America, Europe, Asia and South Africa. In the most recent quarter (Q2 2018), the Malibu U.S. segment comprised 60% of revenue, the Cobalt U.S. segment 34%, and the Australia segment 6%. In addition to earning revenue from the sale of boats and feature upgrades, Malibu Boats also earns revenue through the sale of trailers, parts and accessories. Furthermore, Malibu Boats earns royalty income from licensing out its intellectual property to other boat manufacturers. These additional sources of revenue are allocated amongst the reported segments, as the company deems appropriate.



Source: Company Filings

Manufacturing

Malibu Boats has two boat manufacturing facilities in the U.S. and one in Australia. Since all boats are made of fiberglass, the company heavily relies on this resource for its manufacturing process. In addition, the company purchases engines, resins, hydrocarbon, steel and other product parts from external suppliers. All boat models are manufactured in a continuous flow manufacturing process, involving fabrication, assembly, quality management and testing. Whereas Malibu and Axis models take seven days to manufacture, Cobalt models currently take 14 days.

Distribution

Malibu Boats distributes its boats through a network of independent dealers. As of July 2017, the Malibu and Axis brands were sold in 146 dealer locations across North America. 17% of these dealers sell the Malibu and Axis brands exclusively. Malibu Boats has kept 32% of its North American dealers for over ten years, which highlights the company's success at maintaining long-term partnerships. In addition to the North American market, the Malibu and Axis brands are also sold at 59 dealer locations globally. The acquisition of Cobalt Boats, gave Malibu Boats access to another 142 locations worldwide. In the Boating Industry's Top 100 Dealers survey, 22 of Cobalt Boats' dealers were included, and six were included in the top ten. The quality, quantity and coverage of Malibu Boats' dealership network make it one of the most extensive and sustainable distribution networks in the performance boat industry.

Marketing

Direct Marketing

Malibu Boats utilizes an array of platforms to directly advertise its products to the consumer market. Digital media platforms include a website, Facebook, Twitter and YouTube for the Malibu, Axis and Cobalt brands. In addition, the company engages in print advertising and participates in trade shows.

Indirect Marketing

In supplement to Malibu Boats' direct advertising efforts, the company also benefits from indirect marketing. This includes user-generated content involving the use of Malibu Boats' products that is posted on social media channels, such as Instagram, Vimeo and YouTube. In addition, Malibu Boats hosts sponsored water sports competitions where renowned athletes participate and attract viewership. Finally, Malibu Boats sponsors some of the top performing water sports athletes in the world, which further attracts attention to the company's products.

Brand Reputation

Malibu Boats' history of success has generated a strong reputation for its brand, as evidenced by its market leader position in the U.S. performance sport boat market. The company's financial success allows it to reinforce its brand image by engaging in effective marketing strategies that spread brand awareness. Between 2013 and 2017, Malibu Boats has increased its marketing expenses at a CAGR of 11.8%, while revenues grew at a CAGR of 11.0%. Marketing is undoubtedly a causal factor in facilitating these revenue expansions. While the company's brand is already one of its most valuable intangible assets, continued strengthening of the brand will translate into greater revenue generation. More importantly, the strong brand encourages customers to buy from Malibu Boats instead of competitors, which contributes to the company's economic moat.

Competitive Advantages

Product Portfolio

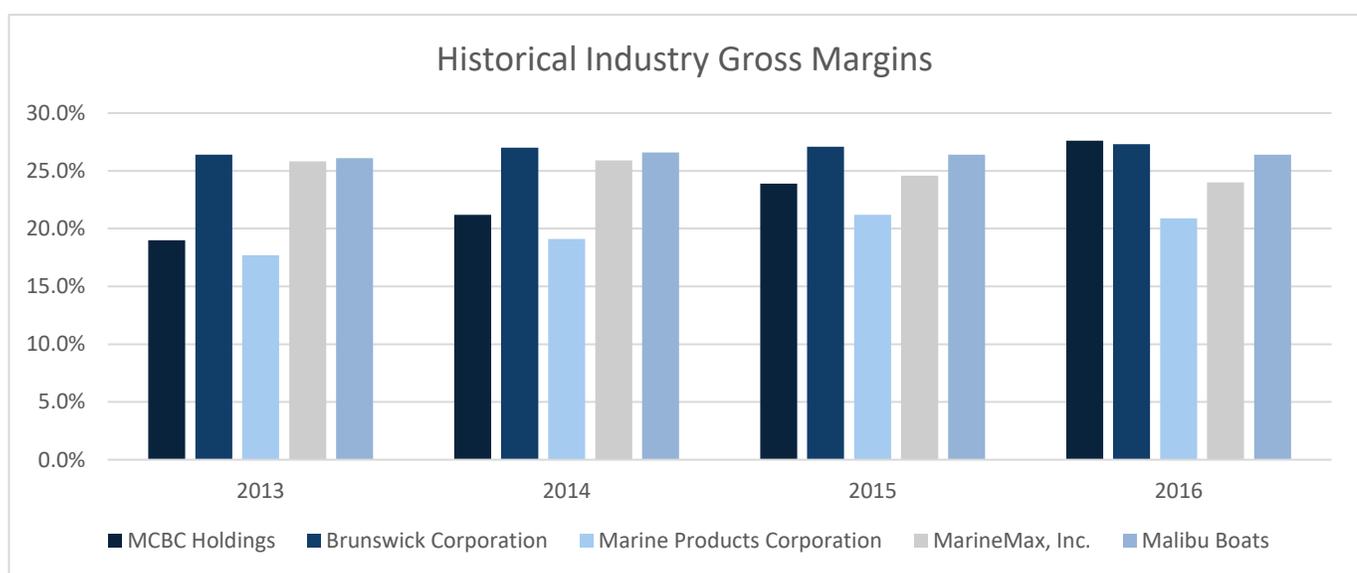
By offering three different boat brands each with multiple product lines, Malibu Boats has a healthy breadth and depth for its product mix. The Malibu, Axis and Cobalt brands all convey performance, comfort and innovation, which creates brand consistency. With 34 boat models across three brands, that range in price, design and functionality, Malibu Boats effectively addresses the performance boat market. Although large and established competitors in the industry tend to offer a similar range of boat models, smaller and upcoming competitors fail to offer an equally extensive selection. Malibu Boats' ability to precisely fulfill different customer needs thus contributes to its economic moat. Malibu Boats also outpaces competitors in the release of new boat models, currently averaging four new models per year. The company's extensive range of boats and related products, as well as its acquisition of Cobalt Boats, likely allow it to realize economies of scope.

Intellectual Property

Malibu Boats develops proprietary technology for its boats, which make the company's products superior to those of competitors and more attractive to consumers. This allows Malibu Boats to charge premium prices for its boats and by equipping new models with the latest features, the company can increase its average selling price over time. Since 2014, Malibu Boats' average unit selling price has increased at a CAGR of 3%, which is well above U.S. inflation levels during the same period. Malibu Boats already owned 28 patents and 32 trademarks across the world prior to the Cobalt Boats acquisition, and the company has an additional five U.S. patents pending. Some of the company's latest patents, including Surf Gate, revolutionize the wakeboarding and surfing experience. Moreover, the company earns royalty income from leasing out its patents to competing boat manufacturers. Continued focus on developing and patenting innovative technology for its boats, allows the company to release on average four new boat models each year, and is likely to boost Malibu Boats' revenue in the future.

Margin Superiority and Rigidity

The company's extensive product portfolio and commitment to innovation have allowed it to consistently generate some of the highest margins in the industry. In the last five years, Malibu Boats has been able to keep its gross margin steady around 26% as shown on the graph, only outperformed by the boating conglomerate Brunswick Corporation. This margin rigidity for a business with a high degree of operating leverage in a highly cyclical industry, reflects effective cost and revenue management. Malibu Boats claims that margins have remained stable due to a stronger U.S. dollar and increased labour costs offsetting lower raw material costs, improved production efficiencies and greater demand for higher-priced products. Efficiency and product mix improvements is a sustainable method to achieve margin expansion. Malibu Boats already exhibits some of the highest margins in the industry, which gives the company significant cash flow advantages over competitors. Higher margins also protect the company in times of economic downturn and against predatory pricing strategies in the oligopolistic boat manufacturing industry.



Source: Company Filings

Vertical Integration

Malibu Boats has vertically integrated the manufacturing process of its boat models, trailers and towers, which allows it to reduce costs and monitor quality. The company's engineering team closely cooperates with the manufacturing team to implement best practices, which enhances efficiencies. At the moment, Malibu Boats is the only performance boat manufacturer who vertically integrated the production of its towers, giving the company design and integration advantages. Malibu Boats entered into an agreement with General Motors that will eliminate intermediary suppliers who integrate the engines for marine use. The agreement begins in 2019 and involves Malibu Boats purchasing engines directly from General Motors and marinizing the engines in-house. Vertical integration of upstream processes allows Malibu Boats to achieve lower costs, greater customization opportunities, and improved quality control for its products.

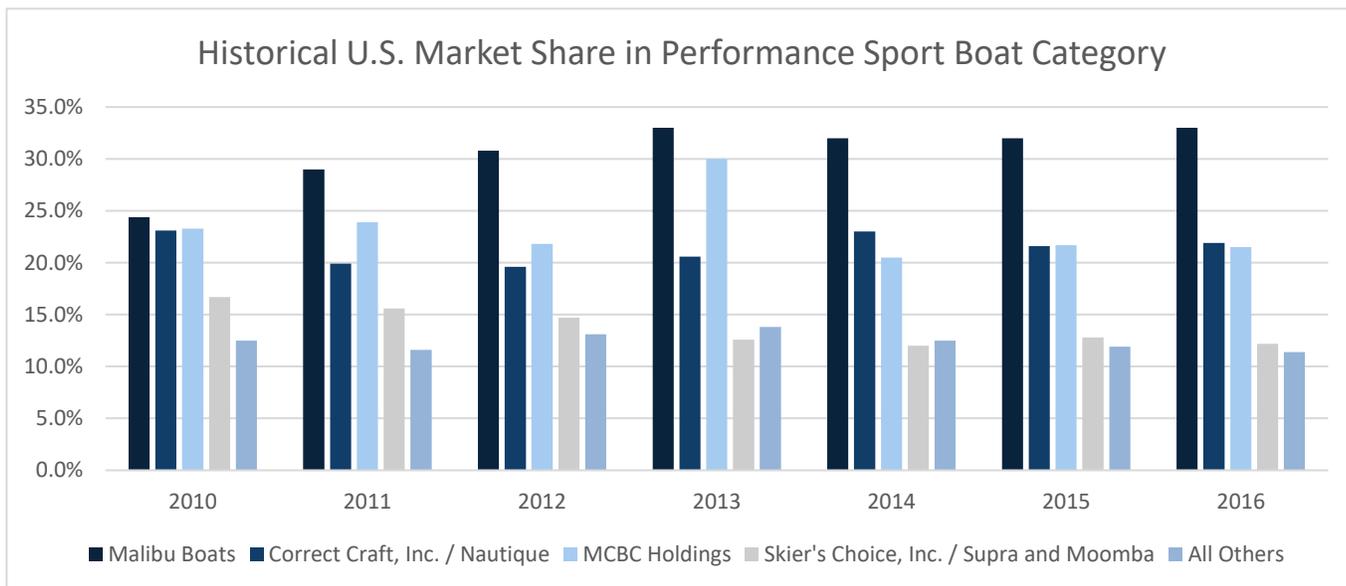
Dealer Relations

By maintaining an extensive, well-managed and sustainable dealership network, Malibu Boats further solidifies its economic moat in the industry. The geographic vastness of the dealership network yields access to a global market. Continued international expansion of the dealership network will increase the addressable market, the consumer base, and thus demand for Malibu Boats' products. The company's ability to maintain long-term partnerships with dealers ensures continued success of the company's distribution network in the future. As outlined above, Malibu Boats' models are offered at numerous high-ranked dealerships, it has kept 32% of its North American dealers for over ten years, and 17% of its dealers exclusively sell Malibu Boats' products. These factors contribute to Malibu Boats' good reputation and will attract more high-quality dealers to join the company's distribution network.

Market Share

U.S. Performance Sport Boat Category

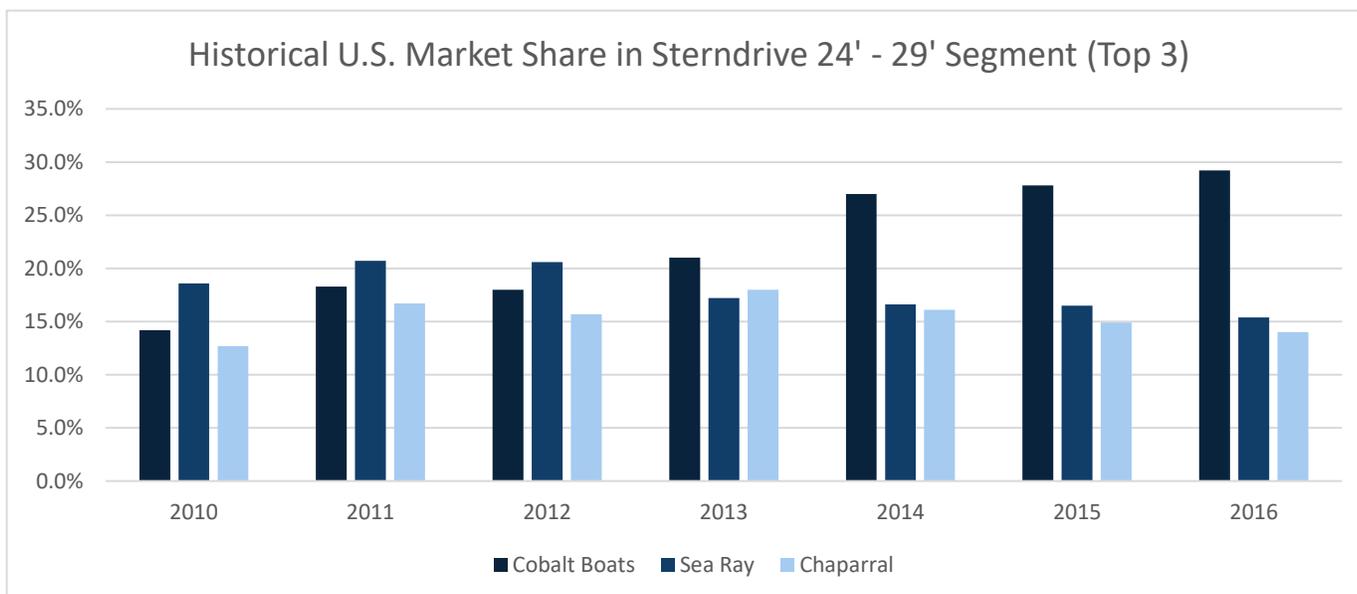
In the performance sport boat category, Malibu Boats has sold the highest number of boats amongst competitors every year since the launch of the Axis brand. In 2010, the combined volume of boats sold through the Malibu and Axis brands gave the company the highest market share in the industry, with 24.4%. Since then, Malibu Boats has progressively increased its market share in the U.S. and attained a 33% share in calendar year 2016. In addition to domestic market share, Malibu Boats also exported 48% of all performance sport boats to international markets during the twelve months ended March 31, 2017.



Source: Company Filings

U.S. Sterndrive 24'-29' Boat Category

Cobalt Boats steadily accrued its share of the 24'-29' sterndrive boat market over the last few years. In 2010, the company had the second largest market share, with 14.2%. Since 2013, Cobalt Boats has been the market leader and in 2016 the company had a 29.2% market share. Malibu Boats' acquisition of Cobalt Boats, gives the company a market leading position in an additional sub-sector.



Source: Company Filings

Economies of Scale

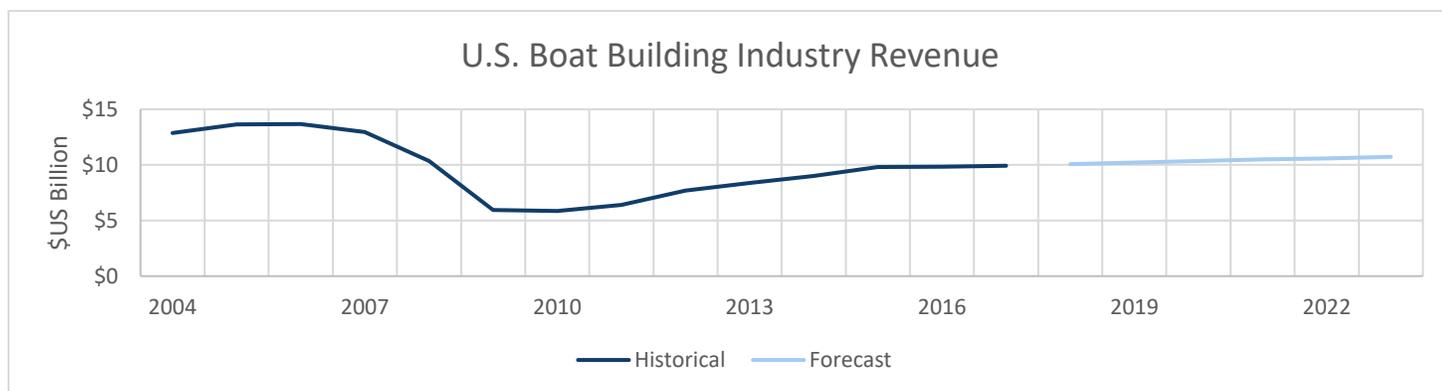
A market leading position is a strong indicator that Malibu Boats achieves economies of scale, as it produces in greater quantities and operates at higher capacity. The company's large dealer network and its vertical integration also signify that it benefits from scale advantages. Malibu Boats' high and stable gross margins already reflect economies of scale, but its recent acquisition of Cobalt Boats will likely introduce new cost synergies that may further improve margins.

Macro Analysis

We believe that revenue generation in the industry is largely determined by macro forces driving demand for boats. We break these forces down into consumer confidence, household income and recreational focus. In addition, we analyzed revenue generation in the boat dealership and repair industry, as this industry will drive downstream demand.

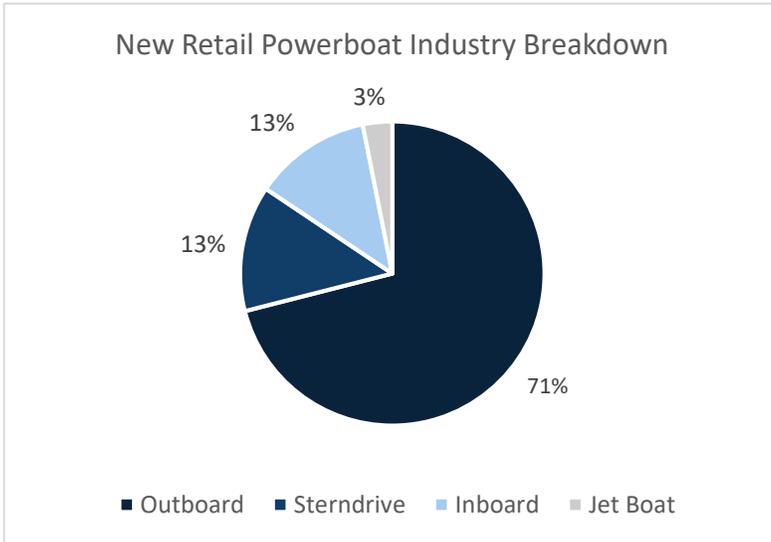
Industry Overview

Malibu Boats operates in the recreational powerboat manufacturing industry, which is a sub-category of the larger boat building industry. The recreational powerboat manufacturing industry is considered mature and generated approximately \$8.2 billion in the U.S. in 2016. Since boat purchases are extremely discretionary, industry revenue is highly cyclical. A recovering economy and strong consumer confidence allowed revenue in the boat building industry to grow at 5.2% per year from 2012 to 2017. IBIS World expects the boat building industry to continue growing at a CAGR of 1.06% through 2023 in line with an economic recovery and growing consumer spending. Brand recognition and product differentiation allow a few large companies to dominate the recreational powerboat industry, making the market oligopolistic. Furthermore, the need for capital-intensive investments, dealership connections, intellectual property and engineering expertise create high barriers to entry.



Source: IBIS World

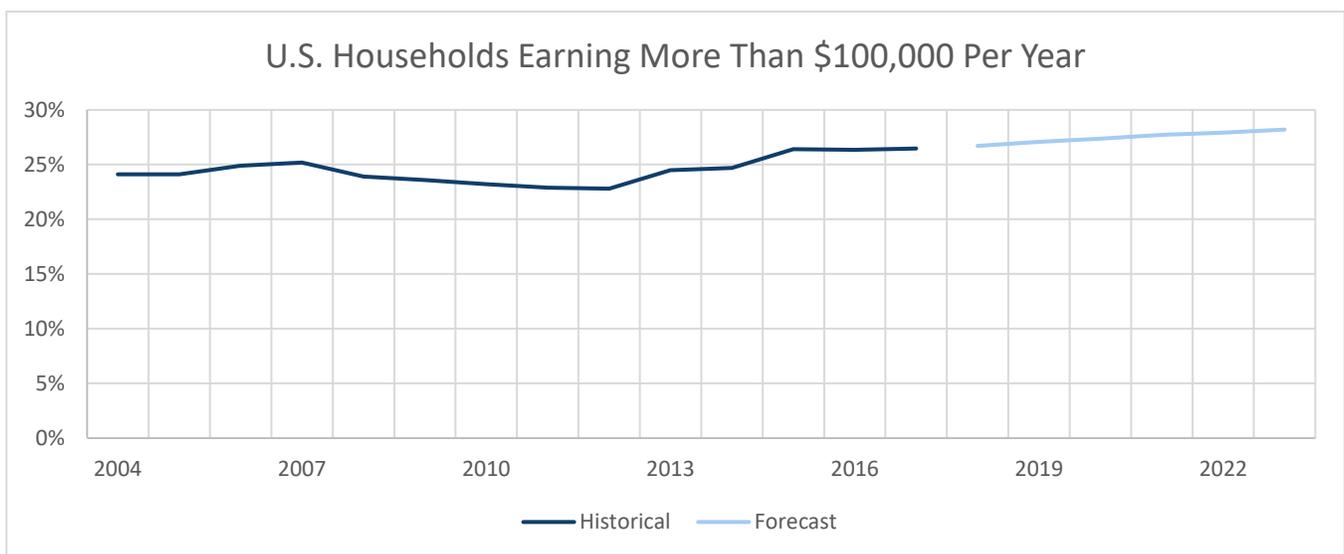
Within the recreational powerboat industry, Malibu Boats addresses the markets for outboard, inboard, sterndrive and jet boats. New retail sales in these categories collectively accounted for \$6.6 billion in the U.S. in 2016. As the chart below illustrates, the market for outboard powerboats accounts for the vast majority, which Malibu Boats now addresses through its strategic acquisition of Cobalt Boats.



Source: Company Filings

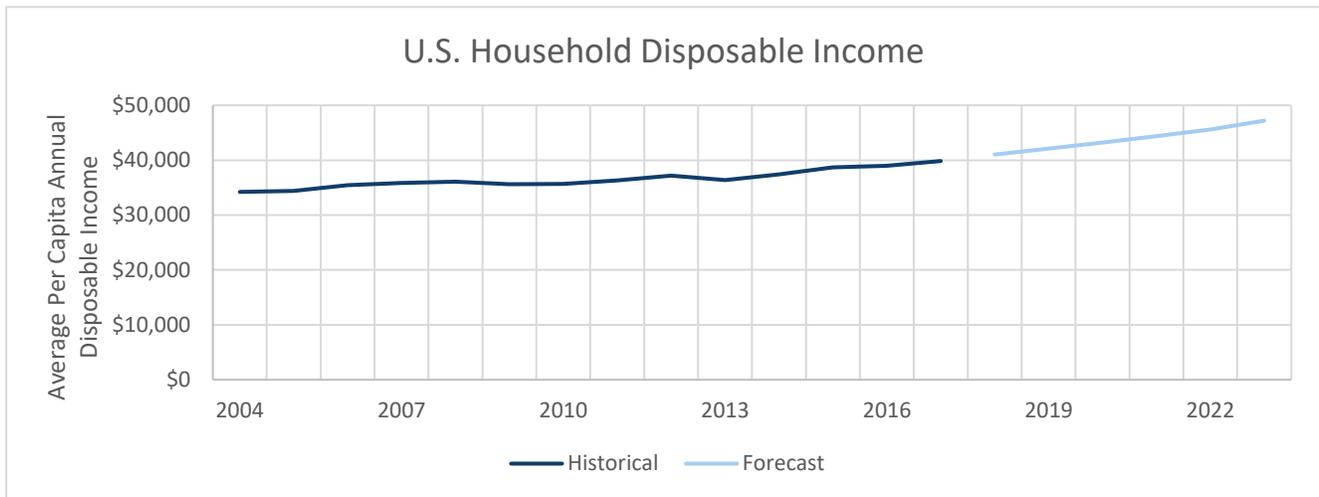
Household Income

Boats are big-ticket purchases and only households with high enough incomes or large enough savings can afford them. The proportion of households earning more than \$100,000 per year is a good indicator of wealth in the economy. The graph below shows how this proportion increased from 24.1% to 26.5% between 2004 and 2017 in the U.S., after adjusting for inflation. While a household earning more than \$100,000 per year is not necessarily able or willing to purchase a boat, the measure provides good indication that an increasing proportion of households belong to the upper middle and upper income classes. IBIS World also predicts that the proportion of households earning more than \$100,000 per year will increase to 28.2% by 2023.



Source: IBIS World

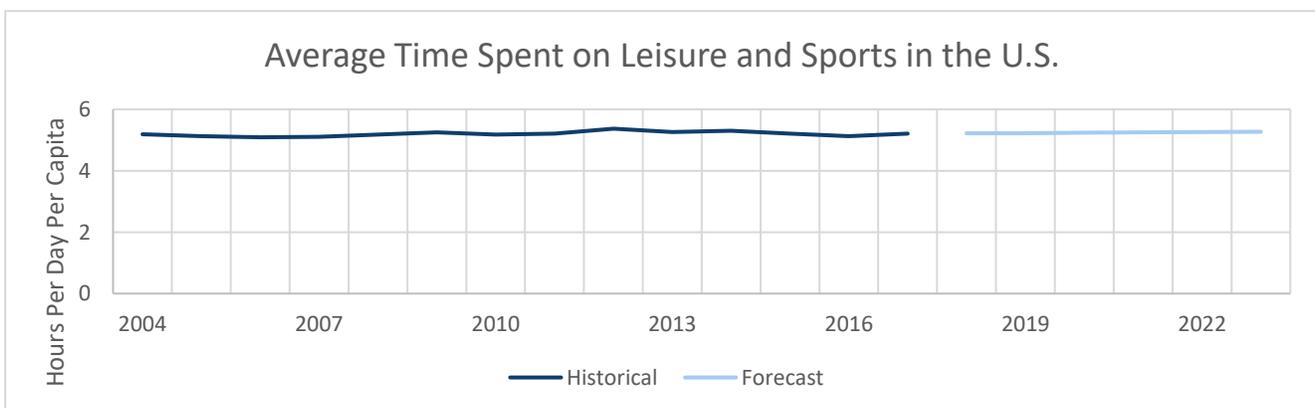
Another measure of household wealth is disposable income, which is residual income after paying mandatory charges that can be spent or saved. Households purchasing a boat would be paying out of this pool of income or out of their accumulated savings of disposable incomes over time. As the graph shows, average disposable income earned by households in the U.S. increased from \$34,224 in 2004 to \$38,850 in 2017. Moreover, IBIS World predicts that household disposable income will continue growing at a CAGR of 2.36% per year through 2023. IBIS World’s forecasts for both household income measures assume that household wealth will further increase over the next six years, which is a positive factor for spurring the demand for boats.



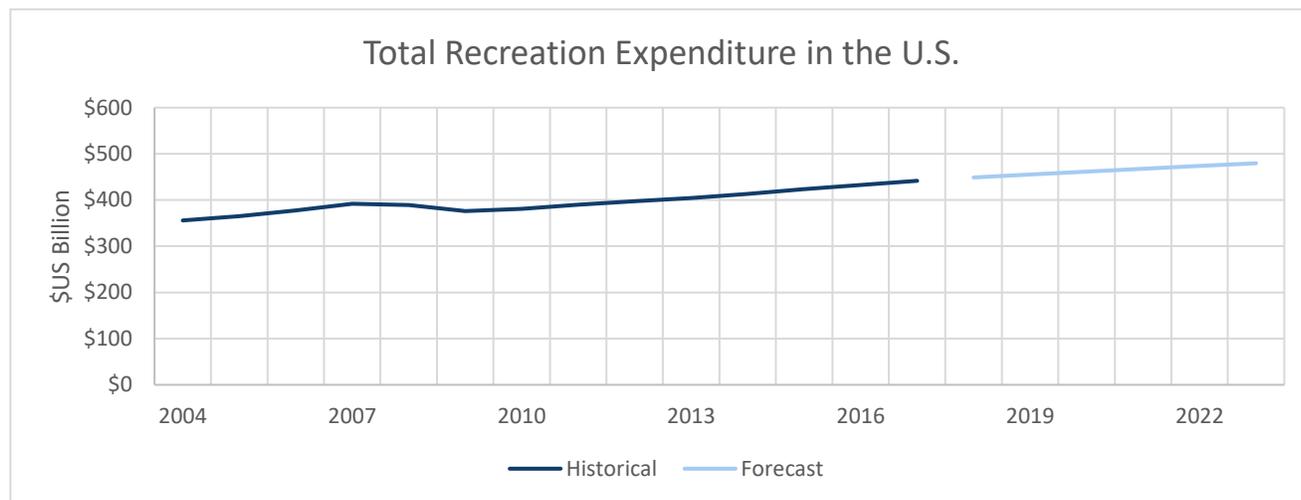
Source: IBIS World

Recreation Significance

Since Malibu Boats sells boats intended for recreational use, the demand for the boats is affected by the amount of money and time consumers spend on recreation. The average time spent by people in the U.S. on leisure and sports has remained relatively steady around 5.2 hours per day since 2004 and IBIS World is not predicting it to change significantly through 2023. However, total recreation expenditure in the U.S. has increased from \$356 billion in 2004 to \$442 billion in 2017.



Source: IBIS World

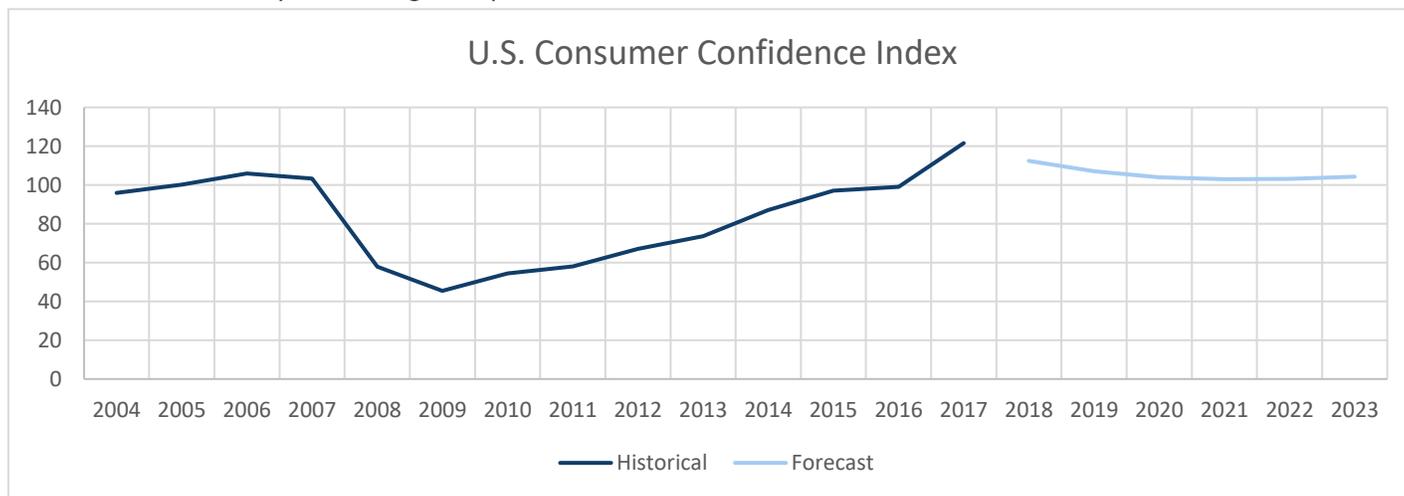


Source: IBIS World

IBIS World expects this expenditure to continue growing at a CAGR of 1.11% until 2023. Hence, while time spent on recreational activities is unlikely to change significantly, recreation expenditure is expected to increase, which can further increase the demand for recreational powerboats.

Consumer Confidence

Boats are big-ticket purchases and households’ feelings about the economy influence the timing of such purchases. Hence the consumer confidence index is a good predictor of boat purchases. The U.S. Consumer Confidence Index shown below illustrates how the 2008 financial crisis caused consumer confidence to plummet. Subsequently it took until 2017 to recover to pre-recession levels. The graph shows there is a strong correlation between the consumer confidence index and revenue generated in the boat building industry. IBIS World expects consumer confidence to drop between 2018 and 2021, which would adversely affect the demand for boats. Nevertheless, Malibu Boats can mitigate the impact of a fall in domestic consumer confidence by continuing its expansion into international markets.



Source: IBIS World

Industry Demand Analysis

In our macroeconomic analysis, we make the assumption that consumer confidence, household income, boat building and recreational focus are the forces that drive demand for Malibu Boats' products. According to IBIS World's forecasts in these domains, Malibu Boats can expect macroeconomic tailwind that may help boost demand. Although consumer confidence is expected to fall, all remaining trends analysed are either expected to remain stable or to increase through 2023. Moreover, all trends appear to be on long-term upward trajectories. We believe that the macro forces in the industry will positively drive demand for the company.

Catalysts

M&A Activity

Malibu Boats acquired Cobalt Boats in July 2017, which increased the company's revenue by 55% in the first quarter of fiscal year 2018. In the months following the acquisition, the company's stock price appreciated significantly and reached a high of \$33 on October 4, 2017. This acquisition was strategic in its nature, because Cobalt Boats is market leader in the sterndrive powerboat industry and its addressable market is more than five times larger than the inboard powerboat and jet boat markets combined. Furthermore, the acquisition is expected to generate approximately \$25.5 million in synergies and tax benefits over the next four years. Although inorganic growth is not integral to Malibu Boats' business strategy and management has not announced specific M&A intentions, consolidation is a trend in the industry. Further M&A activity is at management's discretion and can contribute to earnings growth and stock price appreciation.

International Markets

Although Malibu Boats manufactures its boats only in the U.S. and Australia, the company distributes its products across the world. The company is increasing the size of its dealership network and intensifying marketing efforts in international markets. There is significant potential for increased demand coming from emerging economies, where household incomes are still low, but rising quickly. Malibu Boats expects that particularly Asia and South America represent regions where the opportunity for new demand stemming from rising disposable incomes is prime. Malibu Boats is well positioned to be a leader in harnessing demand from international markets, given its existing leading 48% market share in performance sport boat exports.

Management Team

Mr. Jack D. Springer – Chief Executive Officer and Director

Mr. Springer has served as CEO for Malibu Boats since 2010. He received his Bachelor's in Accountancy from the University of Texas in 1983. Prior to this role, he served as Managing Director at Qorval, LLC, a business consulting firm. Between 2004 and 2007, Mr. Springer was the Chief Integration Officer at Nautic Global Group, where he led the integration of two merging boat manufacturing companies. Mr. Springer's annual compensation is composed of a \$476,000 salary and he holds 0.43% of the company's shares outstanding.

Mr. Wayne R. Wilson – Chief Financial Officer

Mr. Wilson has served as CFO since 2009, prior to which he was the Vice President at Black Canyon Capital. Mr. Wilson received a Bachelor’s in Business Economics from the University of California, Los Angeles. His annual salary is \$258,000 and he owns 0.16% of shares outstanding.

Mr. Ritchie L. Anderson – Chief Operating Officer

Mr. Anderson has served as COO since 2013 but joined the company in 2011 as Vice President of Operations. Before joining Malibu Boats, Mr. Anderson served as Vice President of Operations for MasterCraft, one of the company’s direct competitors. Mr. Anderson has 30 years of experience in the boat manufacturing industry. He receives a \$228,000 annual salary and owns 0.11% of the company’s shares outstanding.

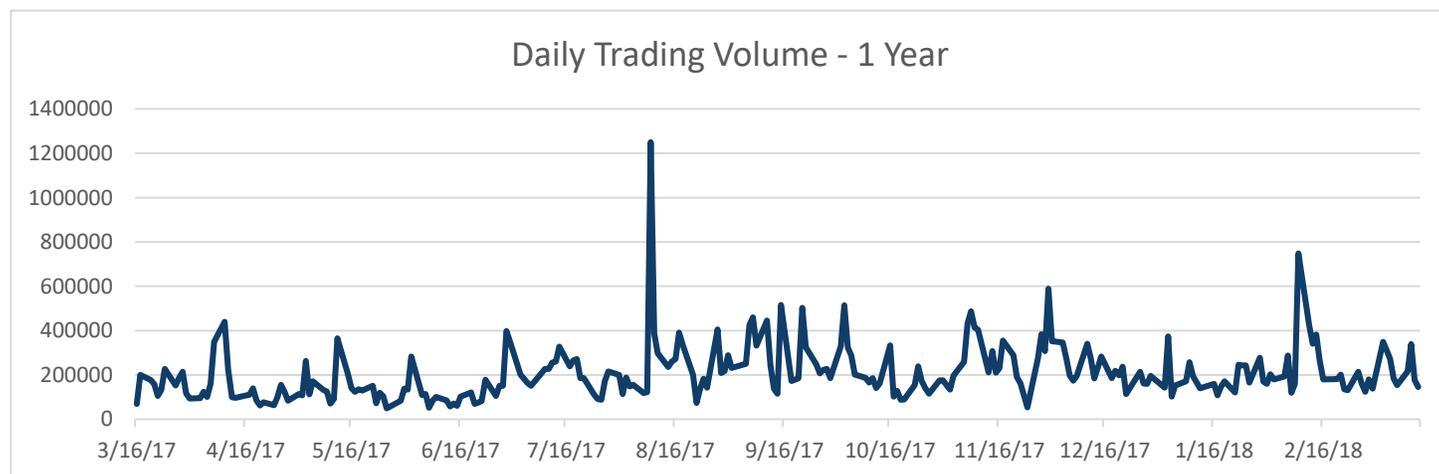
Shareholder Base, Liquidity, Market Depth

Shareholder Base

Malibu Boats is listed on NASDAQ under the ticket MBUU and currently has 20.4 million shares outstanding. BlackRock Institutional Trust Company, RBC Global Asset Management, JP Morgan Asset Management, the Vanguard Group and Macquarie Investment are the company’s largest shareholders and own 7.7%, 6.5%, 5.7%, 5.6% and 5.5% of the company’s shares respectively. Approximately 1.9% of shares are owned by insiders and there is 7.0% short interest amongst outstanding shares.

Liquidity

The stock’s average trading volume over the last twelve months was approximately 207,000. This value excludes August 9, 2017 when trading volume spiked to 1.25 million in relation to an equity issuance. We believe that this trading volume is healthy for the company.



Source: Yahoo Finance

Capital Structure

Malibu Boats currently has \$108 million in debt outstanding and thus a debt-to-equity ratio of 1.0. To finance the acquisition of Cobalt Boats, the company approximately doubled its long-term debt without changing its debt-to-equity ratio. Malibu Boats is in a credit agreement with SunTrust Bank, giving the company access to term loans and a revolving credit facility of up to \$35 million.

Comparable Companies Valuation

Comparable Companies

Brunswick Corporation

Brunswick designs, manufactures and markets boats and marine engines, as well as other lifestyle products. The company owns 20 different brands of boats that range from motor yachts and recreation boats to fishing boats. Brunswick is headquartered in Chicago, Illinois and sells its products in the U.S. and internationally.

MCBC Holdings

MCBC Holdings' MasterCraft is a direct competitor of Malibu Boats in the performance sportboat industry. The company designs and manufactures recreation boats with a focus on water sports applications. MasterCraft is based out of Vonore, Tennessee and sells its products both domestically and internationally.

MarineMax, Inc.

MarineMax is a boat dealership and repair company with locations across the U.S. The company retails various types of new and used recreational boats and yachts, as well as boat accessories and engines.

Marine Products Corporation

Marine Products is a dealer of boats and boat accessories. The company retails a wide range of water sport equipment, including wakeboarding, water skiing and surfing gear. Marine Products is headquartered in Atlanta, Georgia and sells its products globally.

Johnson Outdoors, Inc.

Johnson Outdoors is a manufacturer of various outdoors products, including watercraft. While the company's product mix is more focussed towards fishing, paddling, diving and camping accessories, the recreational nature of these activities is similar to that of watersports, such as surfing, wakeboarding and water skiing. Johnson Outdoors is headquartered in Racine, Wisconsin and sells its products domestically and internationally.

Winnebago Industries

Winnebago Industries manufactures recreational vehicles, primarily motorhomes, used for leisure and outdoor activities. Although the motorhome industry is different from the powerboat industry, the industries exhibit similar product prices and are driven by discretionary incomes and recreation expenditure. Winnebago Industries is based out of Forest City, Iowa and sells its products across North America.

Multiples Valuation

We believe that our choice of comparable companies is reasonable for a multiples valuation approach for Malibu Boats. We decided to use 2019 earnings per share and EBITDA consensus estimates for calculating forward P/E and EV/EBITDA multiples for each comparable company. The means of the EV/EBITDA and P/E multiples were 9.3x and 13.3x, respectively. We applied these multiples to Malibu Boats' 2019 EBITDA and EPS estimates to arrive at intrinsic share values of \$37.00 and \$34.46, respectively.

Discounted Cash Flow Valuation

Revenue Analysis

Malibu U.S. Segment

The company's Malibu U.S. segment has experienced tremendous volume and average selling price increases over the last few years. Our analysis of the expected macroeconomic tailwind, the company's competitive advantages and the unfolding of catalysts makes us confident that revenue trends will continue on an upward trajectory. Particularly the expansion of product mix, the inclusion of more innovative boat features, and the ability to charge premium prices will enforce this trend. We conservatively forecast volume to grow at 4.0% through 2019 and at 2.0% subsequently. In line with the segment's historical unit selling price increases, we expect prices to increase at 3.0% until 2019 and at 2.0% beyond. These assumptions cause segment revenue to grow 7.1% in 2019 and at 4.0% through to 2023.

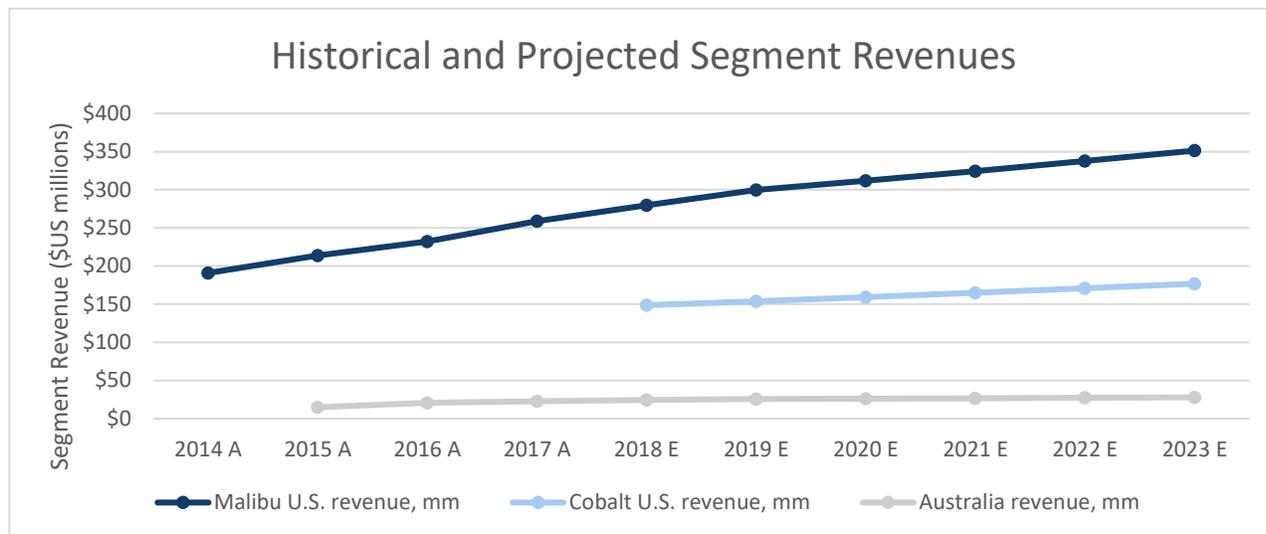
Cobalt U.S. Segment

The only publically available data about Cobalt Boats' historical volume and selling prices is from Malibu Boats' most recent quarterly report. Cobalt Boats has been able to double its market share in the U.S. sterndrive boat industry since 2010. We therefore expect volume in this segment to grow each year and used a conservative growth rate of 1.5%. We believe that the implementation of patented features will also allow average unit selling prices in this segment to increase by 2.0% each year. Hence, we expect revenue to grow at 3.5% per year in this segment.

Australia Segment

In fiscal year 2017, volume in Malibu Boats' Australia segment declined 1.3% and for this reason we do not forecast volume to grow in this segment. However, average selling prices rose 11.7% during the fiscal year, offsetting the volume declines

and causing revenue to grow at 10.3%. We expect average unit selling prices, and therefore revenue too, to grow at 2.0% until 2023 in this segment.



Source: Company Filings

Costs

Cost synergies through the acquisition of Cobalt Boats and enhanced vertical integration through the General Motors contract are likely to reduce manufacturing costs for the company. On the other hand, increasing labour costs, higher raw material prices and integrating new technology into boat models are likely to offset lower manufacturing costs. For this reason, we expect Malibu Boats' COGS margin to remain at historical levels through 2023. We have forecasted the COGS margin to be 73.3% in FY2018 and drop to 70% until 2023. We expect the SG&A expense margin to fall slightly below historic levels over the next few years. Behind this assumption are expected overhead and administrative cost synergies as a result of the Cobalt Boats acquisition.

Effective Tax Rate

In fiscal year 2017, Malibu Boats faced a 36.1% effective tax rate. Malibu Boats will derive benefits out of U.S. President Donald Trump's plan to cut corporate taxes. The company estimates that it will face a 28% effective tax rate going forward, which is the rate we are using in our model.

Capital Expenditures

Management anticipates that capital expenditures will total between \$13 and \$14 million in fiscal year 2018. We trust management's guidance on this estimate. Since Malibu Boats expects to invest heavily into its engine marinization facility in 2018, we expect capital expenditures as a percentage of its property, plant and equipment to drop beyond 2018. Nevertheless, since the company will continue expanding its operations, we forecast capital expenditures to continue increasing going forward.

Depreciation and Amortization

In fiscal year 2017, the company's property and equipment had an estimated useful life of 2.6 years. As this value is in line with historical values, we expect it to remain constant through 2023.

Working Capital

Our working capital assumptions include forecasts for accounts receivable, inventories, prepaid expenses, account payable and accrued liabilities. Going forward, we anticipate that working capital accounts will grow in line with revenue. We believe this is a reasonable assumption, given a lack of management's guidance on capital working forecasts. Moreover, inventory, accounts receivable and accounts payable comprise the majority of working capital, which tend to fluctuate in line with revenue.

Weighted Average Cost of Capital

We assume a 7.0% expected market return and a 2.29% risk-free rate, which reflects the current 5-year U.S. government bond yield of 2.29%. In conjunction with an equity beta of 1.23, as calculated by Bloomberg, the capital asset pricing model yields an 8.1% cost of equity. Since Malibu Boats does not issue bonds, we used Aswath Damodaran's Shipbuilding & Marine industry pre-tax cost of debt of 8.16%, which translates to a 5.9% after-tax cost of debt. Using these inputs, we arrived at a 7.8% WACC that we use to discount our projected cash flows for Malibu Boats.

Discounted Cash Flow Analysis

We used the above assumptions to conduct a discounted cash flow analysis for Malibu Boats. Using a perpetuity growth model with a terminal growth rate of 2.00%, we arrive at a \$45.31 intrinsic share value. In addition, we used an exit multiple approach with a terminal EV/EBITDA multiple of 9.3x, which is the average of the mean of comparable companies' 2019 EV/EBITDA multiple. The exit multiple method yielded an intrinsic share price of \$43.41.

Recommendation

Malibu Boats has demonstrated strength in the recreational powerboat market since the 2008 financial crisis. As a market leader in the performance sport boat category, the company benefits from economies of scale, premium pricing, and distribution advantages. In response, the company has engaged in international expansion, vertical integration and the acquisition of Cobalt Boats. Malibu Boats continues to innovate its product mix, patent proprietary technology and intensify its marketing endeavors, which propels organic growth and strengthens margins. In addition, Malibu Boats has benefitted from the tailwind of a recovering economy and rising consumer confidence. Growing disposable incomes and greater recreation expenditure both domestically and internationally, are economic drivers that we believe will continue to fuel revenue growth. We are confident that the combination of economic moats, a capable management team and favorable long-term macro trends compose strong forces that will ensure Malibu Boats' future success.

Both our discounted cash flow analysis and our comparable companies' analysis indicate that Malibu Boats is undervalued at its current share price. We calculated an average of the intrinsic share prices that we arrived at through our four valuation

approaches. This target price is \$40.00, which represents 20% upside to the current share price and justifies our “buy” rating for Malibu Boats. Given our analysis, we believe the stock is an appropriate purchase for risk-averse investors with a mid- to long-term investment horizon.

Risks

Economic Downturn

Since Malibu Boats’ products are highly discretionary, demand for the products is heavily dependent on household incomes and consumer confidence. In the case of an economic downturn, consumer confidence drops and households defer big-ticket purchases, such as boats. A recession is an inevitable risk that the company faces and its impact will be adverse for the company’s revenue generation. Moreover, Malibu Boats exhibits a high degree of operating leverage, which translates into significant cash flow reductions when revenues fall. The discretionary nature of the company’s products and the high degree of operating leverage, make Malibu Boats’ cash flow generation highly sensitive to the cyclicity of the economy. We believe that an economic downturn poses the greatest risk to the company’s value.

Interest Rate Increases

Interest rates represent households’ cost to borrow money or incentive to save money. When interest rates in the U.S. and other countries increase, households will be more inclined to save, rather than spend money. Over the last year, the Federal Reserve has steadily increased the federal funds rate, which increases interest rates in the U.S. economy. Further interest rate increases can reduce demand for Malibu Boats and have the potential to induce an economic slowdown.

Climate Change

The use of recreational powerboats remains an activity that consumers engage in when the weather is sunny, and the water is still. The onset of global warming intensifies weather conditions, causing summer and winter conditions to become increasingly extreme. This can further augment the seasonality that Malibu Boats experiences in its demand. Moreover, global warming has escalated the frequency and intensity of hurricanes. Particularly the coastal areas of the U.S. are susceptible to the risk of hurricanes occurring, which unfavorably coincides with the locations where Malibu Boats’ products are in high demand. Hurricanes pose the risk of destroying boats parked in docks and the increasing likelihood of hurricanes occurring may deter households from purchasing Malibu Boats’ products.

Appendix 1: Operating Model

Operating Model																								
	Jun-14	Jun-15	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Jun-19	Jun-20	Jun-21	Jun-22	Jun-23		
	FY2014	FY2015	FY2016	Q1-2017	Q2-2017	Q3-2017	Q4-2017	FY2017	Q1-2018	Q2-2017	Q3-2018	Q4-2018	FY2018	Q1-2019	Q2-2019	Q3-2019	Q4-2019	FY2019	FY2020	FY2021	FY2022	FY2023		
Income Statement																								
Revenue	190.9	228.6	253.0	62.0	67.7	77.1	75.1	281.9	103.5	114.4	118.8	116.6	453.3	109.4	120.9	125.8	123.4	479.5	497.5	516.3	535.7	556.0		
COGS (adj. for Depreciation)	140.1	168.2	182.8	46.2	49.8	55.8	50.5	202.3	80.6	86.9	83.1	81.6	332.2	76.6	84.6	88.0	86.4	335.6	348.3	361.4	375.0	389.2		
Gross profit	50.8	60.4	70.2	15.8	17.8	21.4	24.6	79.6	22.9	27.5	35.6	35.0	121.1	32.8	36.3	37.7	37.0	143.8	149.3	154.9	160.7	166.8		
EBITDA	4.7	33.6	41.4	7.3	12.2	13.6	13.1	46.2	12.3	17.0	23.8	23.3	76.3	21.9	24.2	25.2	24.7	95.9	99.5	103.3	107.1	111.2		
Net income	(1.2)	23.2	20.3	4.2	7.7	8.8	10.3	31.1	6.4	(5.6)	13.7	13.4	27.9	12.3	13.9	14.6	14.2	55.1	57.4	59.6	61.9	64.3		
Earnings per share, diluted	\$ -	\$ 0.93	\$ 1.00	\$ 0.21	\$ 0.39	\$ 0.45	\$ 0.53	\$ 1.58	\$ 0.30	\$ (0.31)	\$ 0.67	\$ 0.65	\$ 1.38	\$ 0.61	\$ 0.69	\$ 0.72	\$ 0.71	\$ 2.73	\$ 2.85	\$ 2.96	\$ 3.07	\$ 3.19		
Cash Flow Statement																								
Cash flow from operating activities	23.8	12.6	35.6	6.7	15.6	8.4	5.2	35.9	5.0	22.0	18.1	17.3	62.4	16.5	17.2	18.3	18.3	70.3	73.3	76.0	79.0	82.1		
Cash used in investing activities	(5.9)	(17.1)	(6.0)	(0.8)	(4.6)	(1.5)	(2.3)	(9.2)	(127.4)	(3.1)	(4.2)	(4.2)	(138.9)	(4.3)	(4.3)	(4.3)	(4.4)	(17.3)	(17.7)	(18.4)	(19.2)	(19.9)		
Cash from financing activities	(21.6)	0.7	(12.0)	(15.4)	(1.5)	(0.4)	(2.4)	(19.7)	107.9	(0.6)	-	-	107.3	-	-	-	-	-	-	-	-	-		
Net change in cash	(3.8)	(3.8)	17.5	(9.6)	9.6	6.4	0.5	6.9	(14.4)	18.3	13.9	13.1	30.9	12.3	12.9	13.9	13.9	53.1	55.6	57.6	59.9	62.2		
Balance Sheet																								
Total current assets	34.3	39.6	64.7	58.8	59.7	76.7	70.1	70.1	83.5	96.6	118.5	130.3	130.3	138.6	157.9	174.6	187.2	187.2	243.4	303.7	366.2	431.3		
Total non-current assets	50.5	160.7	157.6	154.6	156.1	158.3	153.6	153.6	278.0	231.8	232.2	232.6	232.6	233.0	233.4	233.9	234.3	234.3	236.0	237.7	239.5	241.4		
Total assets	84.8	200.3	222.3	213.4	215.8	235.0	223.7	223.7	361.5	328.4	350.7	363.0	363.0	371.6	391.4	408.5	421.5	421.5	479.4	541.4	605.8	672.7		
Total current liabilities	43.0	33.5	47.8	44.3	39.7	46.6	39.2	39.2	57.1	56.8	65.4	64.3	64.3	60.7	66.5	69.0	67.8	67.8	68.3	70.7	73.2	75.7		
Total non-current liabilities	13.8	165.5	154.5	146.2	145.9	146.6	132.2	132.2	189.8	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0	161.0		
Total liabilities	56.7	199.0	202.3	190.4	185.6	193.2	171.4	171.4	247.0	217.8	226.4	225.3	225.3	221.6	227.5	230.0	228.8	228.8	229.3	231.7	234.1	236.7		
Total equity	28.1	1.3	20.0	23.0	30.2	41.8	52.2	52.2	114.5	110.6	124.3	137.7	137.7	150.0	163.9	178.5	192.7	192.7	250.1	309.7	371.6	436.0		

Appendix 2: Discounted Cash Flow Analysis

Discounted Cash Flow Analysis														
	Jun-14	Jun-15	Jun-16	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Jun-18	Jun-19	Jun-20	Jun-21	Jun-22	Jun-23
	FY2014	FY2015	FY2016	FY2017	Q1-2018	Q2-2018	Q3-2018	Q4-2018	FY2018	FY2019	FY2020	FY2021	FY2022	FY2023
Free Cash Flow														
EBIT	(0.5)	31.2	35.9	39.4	11.0	15.7	20.0	19.5	66.1	80.3	83.5	86.6	89.8	93.1
Less: Tax expense	0.1	(8.7)	(10.1)	(11.0)	(3.1)	(4.4)	(5.6)	(5.5)	(18.5)	(22.5)	(23.4)	(24.2)	(25.1)	(26.1)
Add: Depreciation and amortization	5.2	2.5	5.5	6.7	1.3	1.3	3.8	3.8	10.2	15.6	16.0	16.7	17.3	18.0
Less: Capital expenditures	(5.9)	(5.4)	(6.2)	(9.3)	(1.8)	(3.1)	(4.2)	(4.2)	(13.3)	(17.3)	(17.7)	(18.4)	(19.2)	(19.9)
Less: Change in net working capital	(3.3)	(25.0)	(2.4)	(3.5)	(6.2)	5.2	0.6	0.1	(0.3)	(0.4)	(0.1)	(0.2)	(0.3)	(0.3)
Unlevered free cash flow	(4.4)	(5.5)	22.8	22.4	1.2	14.7	14.6	13.8	44.2	55.8	58.4	60.3	62.6	64.9
Discount factor					-	-	0.25	0.50	0.50	1.50	2.50	3.50	4.50	5.50
Present value of unlevered free cash flow					-	-	14.3	13.3	27.6	51.2	48.4	46.4	44.6	42.9

Cost of Equity	
Risk-free rate	2.3%
Expected market return	7.0%
Market risk premium	4.7%
Beta	1.23
Cost of equity	8.1%

Cost of Debt	
Pre-tax cost of debt	8.2%
Effective tax rate	28.0%
Cost of debt	5.9%

WACC	
Total market value of equity	681.1
Total book value of debt	108.2
Total capitalization	789.3
Cost of equity	8.1%
Cost of debt	5.9%
WACC	7.8%

Perpetuity Growth Rate	WACC				
	8.79%	8.29%	7.79%	7.29%	6.79%
1.00%	\$ 34.37	\$ 37.01	\$ 40.04	\$ 43.55	\$ 47.67
1.50%	\$ 36.13	\$ 39.08	\$ 42.50	\$ 46.52	\$ 51.29
2.00%	\$ 38.15	\$ 41.48	\$ 45.39	\$ 50.04	\$ 55.66
2.50%	\$ 40.50	\$ 44.30	\$ 48.83	\$ 54.31	\$ 61.06
3.00%	\$ 43.24	\$ 47.65	\$ 52.99	\$ 59.56	\$ 67.88

Terminal EV/EBITDA Multiple	WACC				
	8.79%	8.29%	7.79%	7.29%	6.79%
7.5 x	\$ 34.51	\$ 35.35	\$ 36.21	\$ 37.09	\$ 38.00
8.5 x	\$ 37.93	\$ 38.86	\$ 39.81	\$ 40.79	\$ 41.79
9.5 x	\$ 41.36	\$ 42.37	\$ 43.41	\$ 44.48	\$ 45.59
10.5 x	\$ 44.78	\$ 45.88	\$ 47.02	\$ 48.18	\$ 49.38
11.5 x	\$ 48.21	\$ 49.40	\$ 50.62	\$ 51.88	\$ 53.17

Appendix 3: Comparable Company Analysis

		EV/EBITDA Multiple				P/E Multiple					
Company	Ticker	Equity Value	Enterprise Value	LTM EV/EBITDA	NTM EV/EBITDA	2018E EV/EBITDA	2019E EV/EBITDA	LTM P/E	NTM P/E	2018E P/E	2019E P/E
Brunswick Corporation	NYSE:BC	5,290.5	5,279.1	11.7 x	8.0 x	8.0 x	7.4 x	16.0 x	13.2 x	13.2 x	11.9 x
MCBC Holdings, Inc.	NASDAQ:MCFT	478.6	567.3	14.0 x	9.4 x	10.0 x	8.8 x	17.6 x	12.8 x	14.0 x	11.4 x
MarineMax, Inc.	NYSE:HZO	527.6	799.8	13.8 x	12.3 x	12.4 x	11.3 x	17.7 x	14.5 x	13.9 x	12.1 x
Marine Products Corporation	NYSE:MPX	499.4	491.7	15.3 x	13.6 x	13.6 x	12.5 x	24.0 x	19.9 x	19.6 x	18.1 x
Johnson Outdoors, Inc.	NASDAQ:JOUT	583.7	510.7	9.0 x	9.3 x	9.3 x	8.3 x	17.7 x	19.1 x	20.7 x	16.4 x
Winnebago Industries	NYSE:WGO	1,359.8	1,576.1	9.3 x	8.4 x	8.9 x	7.5 x	17.5 x	11.8 x	12.7 x	9.7 x
Malibu Boats, Inc.		681.1	757.6	13.3 x	8.9 x	9.2 x	8.5 x	16.3 x	13.5 x	15.0 x	12.8 x
Median				12.7 x	9.3 x	9.6 x	8.6 x	17.6 x	13.9 x	13.9 x	12.0 x
Mean				12.2 x	10.2 x	10.4 x	9.3 x	18.4 x	15.2 x	15.7 x	13.3 x
High				15.3 x	13.6 x	13.6 x	12.5 x	24.0 x	19.9 x	20.7 x	18.1 x
Low				9.0 x	8.0 x	8.0 x	7.4 x	16.0 x	11.8 x	12.7 x	9.7 x
				EV/EBITDA Implied Price			P/E Implied Price				
Median				\$ 35.24	\$ 35.20	\$ 33.78		\$ 34.25	\$ 30.95	\$ 31.09	
Mean				\$ 38.73	\$ 38.13	\$ 37.00		\$ 37.54	\$ 34.78	\$ 34.46	
High				\$ 53.01	\$ 51.24	\$ 51.07		\$ 49.08	\$ 45.87	\$ 47.01	
Low				\$ 29.71	\$ 28.57	\$ 28.79		\$ 29.02	\$ 28.12	\$ 25.28	

Appendix 4: Valuation Summary

Current Price	\$ 33.34
Target Price	\$ 40.05
Total Return	20.11%
Recommendation	BUY

		Method	Bear	Base	Bull
DCF	Perpetuity Growth		\$ 34.37	\$ 45.31	\$ 67.88
	Exit Multiple		\$ 34.51	\$ 43.41	\$ 53.17
COMPS	EV/EBITDA Multiple		\$ 28.79	\$ 37.00	\$ 51.07
	P/E Multiple		\$ 25.28	\$ 34.46	\$ 47.01

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