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DOO.TO - Q2 2018 BRP Inc Earnings Call

EVENT DATE/TIME: AUGUST 30, 2018 / 1:00PM GMT



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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the BRP Inc's. Q2 Fiscal Year 2019 Earnings Conference Call.

I would now like to turn the meeting over to Mr. Philippe Deschenese. Please go ahead, Mr. Deschenese.

Philippe Deschenese

Thank you, Elena. Good morning, and welcome to BRP's conference call for the second quarter of fiscal year 2019. Joining me on the call this morning are José Boisjoli, President and Chief Executive Officer; and Sebastien Martel, Chief Financial Officer.

Before we move to the prepared remarks, I would like to remind everyone that certain forward-looking statements will be made during the call that are subject to a number of risks and uncertainties. I invite you to read BRP's MD&A for listing of these. Also during the call, reference will be made to supporting slides, and you can find the presentation on our website at brp.com under the Investor Relations section.

So with that, I'll turn the call over to José.

José Boisjoli - BRP Inc. - President, CEO & Director

Thank you, Philippe. Good morning, everyone, and thank you for joining us. I'm happy to report that we continued our positive momentum into this quarter as we once again delivered solid results and our best second quarter ever.



The demand for all our product lines remained robust, driving retail sales growth that continued to outpace our industry around the world.

We also achieved significant milestone on projects that will allow us to sustain our growth trajectory in the future, notably by completing 2 acquisition and the creation of the new Marine group. True with all, our team continued strong execution by increasing production capacity in our sites and are gearing up for new product launches at our upcoming dealer meeting.

Our result came in ahead of our expectation for the quarter, and given the positive momentum we are experiencing and the good visibility we have on the back half of the year, we are comfortable increasing our guidance for the end of the year with normalized EPS growth of 30% to 35%.

Now let's turn to the financial highlights of the quarter on Slide 4. Our revenue reached a record level for second quarter at \$1,207,000,000, representing a year-over-year growth of 18%, driven by the continued strong demand for our side-by-side and personal watercraft lineups.

Our gross profit margin were up 210 basis point, leading to a 72% increase in normalized EBITDA, which reached \$144 million and a 230% increase in normalized earning per share, that ended at \$0.66. Our retail sales growth was also impressive. In North America, the retail pace picked up starting in May and continue for all the quarter after a difficult month of April due to unfavorable weather, as you remember.

Our powersport product retail grew 16% in an industry that was up high single digit in the quarter. We outpaced all our sectors, as our Can-Am offroad and Sea-Doo lineups continued to drive strong consumer demand and as the retail of the Can-Am Spyder picked up after a slow start of the season.

Our retail momentum was also strong around the world, mainly driven by our Can-Am side-by-side and Sea-Doo personal watercraft, which are gaining traction in all our major markets. Our powersport product are also performing well and outpaced the industry in all region with retail up 13% in Latin America, 11% in EMEA and 21% in Asia Pacific.

As you are aware, by the sheer amount of activity, another sector that has seen healthy growth over the last few years is the marine industry. To reinforce our presence in that industry and leverage our Evinrude assets, we announced earlier this summer the creation of the Marine group. Our objective is clear: To become a leading global marine company. And our strategy to achieve that objective is buy, build and transform. Concretely, we want to create a global marine business through acquisition to reach a critical mass, allowing us to accelerate our presence and be a significant player in the industry. We'll then drive growth and efficiency by optimizing the dealer network, driving conversion to Evinrude engine, capitalizing on shared opportunity between brands and leveraging each brand know-how and expertise.

And based on our recognized approach to innovation and design expertise, we believe that we will -- we have the ability to transform the industry and to do for the marine business what we have done for the powersport business.

As a first step toward achieving our objective, we completed this summer 2 boat company acquisition: First, with the acquisition of Alumacraft, a premier manufacturer of aluminum fishing boat; and secondly, with the well-known Manitou Pontoon company in Q3. These acquisition allow us to enter the aluminum all-around fishing and pontoon segments, which are the 2 fastest growing segments and represent over 50% of the U.S. boat industry.

Entering the boating industry is a natural next step for us, and it represents many opportunities in term of leveraging the network of 275 Alumacraft dealers, 150 Manitou dealers and over 1,000 Evinrude dealers in North America. We are pleased to welcome these 2 companies and their 400 employees to the BRP family. They provide us, along with Evinrude, strong foundation on which to build our Marine group.

Now quickly before moving to the review by product category, the creation of the Marine group requires adjustment relating to our segment reporting. This will result in some slight changes to the product category for which we report revenue. Year-Round Product and Seasonal Product will remain as is. However, the propulsion system and PAC category will change and will now be the Powersport PAC and OEM Engines category, which will include PAC revenue for Year-Round and Seasonal Product as well as OEM engine for kart, motorcycle and recreational aircraft; and the Marine Engine, Boat and related PAC.



Now let's turn to Slide 10 for Year-Round Product highlights. Revenue were up 23% -- 26% for the quarter, driven by a higher volume and favorable product mix of side-by-side. On the retail side, both Can-Am side-by-side and ATV ended their 2018 season on a strong note. For side-by-side, the North American industry completed its 2018 season on June 30 with retail up high single-digit percentage. For the same period, Can-Am side-by-side retail was up in the mid-30%, gaining market share in both the utility and sports segments. We are seeing solid growth across the lineup, and the popularity of our specialized models, such as the Defender LONE STAR, the Maverick X3 rock crawler and our mud-ready Maverick X3 and Defender, is helping us deliver superior profitability for us and our dealers. Our side-by-side business also continued to grow rapidly in international market with retail sales in Western Europe, Latin America and Asia Pacific region, all growing above 25% in the quarter.

Turning to ATV. The North American ATV industry also ended its 2018 season on June 30 with retail down low single digit. For the same period, Can-Am ATV is up mid-single digit and ended the season with the #3 market share position in the North American market, a first for the Can-Am ATV.

Now looking at Spyder. Nine months into the 2018 season, the North American 3-wheel motorcycle industry is down high single-digit percentage, impacted early into the season by unfavorable weather. Can-Am Spyder retail was also down high single digit over the same period as retail picked up in the second quarter with a growth in the low-teen percent.

Turning to Seasonal Product on Slide 11. Seasonal Product revenue were up 21%, driven by a higher volume and favorable mix of personal watercrafts sold as well as a favorable mix of snowmobiles sold. Looking at retail sales for personal watercraft 10 month into the season, the North American industry retail is up high single-digit percentage.

Sea-Doo retail is up low-teen percent over the same period, notably achieving strong market share gain in the higher-end segment of the industry, driven by the success of the new platform and its multiple innovative new feature such as better riding, handling and the ease of use of our accessories and the popular new audio system.

While Sea-Doo growth in North America is solid, the growth in the rest of the world is even more impressive, with quarterly retail growing over 25% in EMEA and Asia Pacific region and over 60% in Latin America.

Continuing with a quick look at the 2 new revenue reporting category. Starting with the Powersport PAC and OEM Engines category, revenues were up 3% in the quarter as the continued growth of our accessories sales, notably for side-by-side and personal watercraft, was partially offset by a lower volume of motorcycle engines sold due to the conclusion of the supply agreement with BMW.

Revenue for the Marine Engine, Boat and PAC category were about flat in the quarter compared to last year as a slight decline in outboard engine volume was offset by one month of Alumacraft revenue following its acquisition.

Looking at retail sales. The North American outboard engine industry completed its 2018 season on June 30, up mid-single digit and with Evinrude retail down low single digit.

And with that, I will turn the call over to Sebastien and will return for closing remarks.

Sebastien Martel - BRP Inc. - CFO

Thank you, José, and good morning, everyone. Our momentum continued in the second quarter as we delivered solid results that came in ahead of our expectations.

Revenue reached \$1,207,000,000 for the quarter, up 18% over last year. We saw a growth in all regions, driven by Year-Round Products, Seasonal Products and our Powersport PAC and OEM Engines category.



Our gross profit margin was up 210 basis points and reached 23.2%, driven by favorable volume and product mix, primarily coming from our snowmobile, personal watercraft and Can-Am SSV lineups and favorable pricing. These elements were partly offset by higher production and distribution costs. Normalized EBITDA was up 72% to \$144 million, and the normalized EPS reached \$0.66.

We generated \$64 million of free cash flow and invested \$53 million on CapEx. We also completed the Alumacraft acquisition in the quarter for a total consideration, net of cash acquired, of \$80 million. The Manitou acquisition, which closed this week, will be reported in our Q3 results. These acquisitions were done with cash on hand and using our revolving credit facility.

Turning to Slide 15. Our normalized net income grew \$43 million in the quarter, resulting from a net favorable impact of volume, mix, pricing and sales programs for \$73 million and a favorable foreign exchange rate impact of \$12 million, partly offset by higher production, distribution and depreciation expense for \$15 million, higher operating expenses for \$15 million as we continue building our brand awareness through marketing efforts and higher normalized financing costs and normalized income tax expense for \$12 million.

Now moving to the network inventory position on Slide 16. Our network inventory is up 7% over last year's second quarter level, resulting from the increase in inventory of our Can-Am SSV and PWC lineups to support continued growth in consumer demand. Partly offsetting these elements was a reduction in snowmobile network inventory, resulting from the good end of season we had last winter. Our network inventory position is very healthy for all product lines.

And finally, turning to Slide 17 for an update of fiscal year '19 guidance. Before getting into the numbers, as José mentioned earlier, the creation of the Marine group has resulted in some adjustments to our segment reporting, and we have adjusted our guidance to reflect these changes. All in all, the basis for the guidance remains unchanged with the exception of the modification of 2 product categories.

Starting with this quarter and going forward, we will provide guidance on 2 new product categories: Powersport PAC and OEM Engines; and Marine Engines, Boats and PACs. And we will cease providing guidance on Propulsion Systems and PAC product categories. The basis for all other metrics, on which we are guiding, remains unchanged.

And now on with the numbers. In light of a better-than-planned results we have achieved so far this year, the continued strong momentum with our side-by-side business, supported by the additional capacity of the Juarez 2 plant, the sustained and robust worldwide demand for personal watercraft, given the good retail season we are having, the improved outlook for the upcoming snowmobile season and the acquisition of the Alumacraft and the Manitou boat companies, we are increasing our revenue guidance for Year-Round Products to up 18% to 21% and for our Seasonal Products guidance to up 9% to 12%.

Our initial guidance for Powersport PAC and OEM Engine starts with a range of up 3% to 7% with the underlying assumption in growth in PAC partly offset by the reduction in volume of motorcycle engines sold to BMW.

And our initial guidance for Marine Engines, Boat and PAC is a range of up 15% to 20% with the bulk of the growth resulting from the addition of the boat businesses we have acquired.

Our total company revenues are now expected to grow 12% to 16% with 2% of that growth coming from the 2 boat company acquisition. The total company revenue also includes a 2% increase versus our previous guidance coming from favorable foreign exchange rates.

Our normalized EBITDA growth has been reviewed upward by 3%. It is now expected to be up 20% to 22%, and our normalized EPS now expected to grow 30% to 35%.

The strong momentum we have is allowing us to increase our guidance for the year despite the continued headwinds coming from inflationary pressures, notably related to commodities, tariffs and freight costs. These elements represent a negative impact of \$20 million versus our initial guidance that we provided in March and a negative impact of \$5 million versus our updated guidance we shared with you in May. Based on current trends, we expect that the continued inflationary pressures could impact next year by an additional \$25 million over this year.



As for the boat company acquisitions, their impact on our bottom line is expected to be limited this year, given the third and fourth quarters are typically softer in terms of profitability due to the timing of boat deliveries, which are usually more concentrated in the first half of the year. On a full year basis, their impact, in terms of normalized EPS, is estimated at about \$0.10.

Finally, a quick word on our expectations for the back half of the year. We expect the third quarter normalized EBITDA to come in similar to last year as a better mix of products sold is expected to be offset by higher operating expenses and a lower volume of snowmobiles sold due to the timing of production, which will shift some deliveries to the fourth quarter. This implies that all of the H2 normalized EBITDA growth is expected to be generated in the fourth quarter, driven by the continued strength across the business and by the shift of some snowmobile shipments from Q3 to Q4. That being said,

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visibility on the back half of the year and are confident in our ability to deliver on our guidance.

With this, I will turn the call back to José.

José Boisjoli - BRP Inc. - President, CEO & Director

Thank you, Sebastien. Before I conclude my remarks for this quarter, allow me to take a few moments to share with you an update on our 2020 Challenge.

You will remember that we've launched 3 key objective for the organization in April 2015 with a focus on growth, agility and being a lean enterprise. These were intended to get us to our objective to delivering \$3.50 in normalized EPS by fiscal year '21. We have been pleased with the progress we have experienced to date on almost every level. We have more than doubled our side-by-side retail volume since 2015 with 6 new platform introduced over the past 3 years. Our ATV market share has made it to the top 3 in North America during that period. Our personal watercraft and snowmobile market share have reached record levels. We have developed value proposition for dealer engagement that is the best in the industry. We have returned over \$900 million in capital to shareholders through share repurchase and dividend. And as you're aware, our marine strategy is now launched with the acquisition of 2 boat company and the creation of the new Marine group.

All of these accomplishment have been made possible by our dedicated workforce around the world and our focus on our strategic initiative. Despite the current geopolitical and economic climate, and resulting headwind such as commodity tariff impact and freight costs, our strong momentum should allow us to achieve our objective to deliver at least \$3.50 of normalized EPS in fiscal year '20, one year earlier than initially planned.

As for Q2, it is clear that we have been on the positive trend. There are a few highlights, I believe, worth sharing. Our latest results show strong retail momentum in most sector end markets. The team is growing -- is showing great progress in improving the capacity at the Juarez 2 plant, which will be operational in H1 fiscal year '20. The introduction of the new side-by-side model has been positively received by dealers and consumers. The creation of the Marine group will led us into new opportunities and help to unlock Evinrude full potential. We are increasing our guidance for fiscal year '19 as Sebastien remarked. And finally, as I just mentioned, we are on the right path to deliver the 2020 objective one year in advance and have no plan to stop there.

All in all, we are very pleased with this quarter but are taking nothing for granted. We continue steadily in our plan with the same strategic focus to continue to deliver the best result possible, both for our customers and for our shareholders.

To conclude, we have a lot of good news to share with you at our upcoming BRP Club. I look forward to seeing many of you there on September 9 and 10 in Denver, Colorado. On that note, I will turn the call over to the operator for question.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Robin Farley with UBS.

Robin Margaret Farley - *UBS Investment Bank, Research Division - MD and Research Analyst*

I wonder if you could put some more granularity around where you think Evinrude sales growth can go with the new marine strategy. And then also, any sort of broad outlines about your market share targets in Marine? And at this point, will you grow -- are you looking to do more acquisitions or just, sort of, organic and synergy growth from here with these recent acquisitions?

José Boisjoli - *BRP Inc. - President, CEO & Director*

First, we have a long-term plan, and our acquisition strategy is about buy, build and transform. And I will say the buy and build, and like you saw in the slide that we just presented, there is a lot of opportunities when you look only at the dealer network of Alumacraft and Manitou and Evinrude in North America. Then today, if I look, Alumacraft is about high single-digit market share of the aluminum fishing boat, and Manitou is low single-digit market share. Then obviously, those 2 brand is offering us a good base to grow market share, but again, it's a long-term play. And on top of it, you're adding the dealer network optimization between the Evinrude, Alumacraft, Manitou dealer network, the conversion to Evinrude, then there is a lot of opportunity, and that's why we invested in those product category. But it's too early for us to give you some color on the long-term plan. It's something that we'll do in the coming months.

Robin Margaret Farley - *UBS Investment Bank, Research Division - MD and Research Analyst*

And is the thought that you're still looking to roll up other brands out there in Marine?

José Boisjoli - *BRP Inc. - President, CEO & Director*

I mean, we -- there is many, many company for sales in the world. And obviously, we still looking. But we are very happy with those first 2 acquisition. The quality of the brand, Alumacraft had been there 70 years, Manitou for a long time. The quality of the brand, the quality of the product is offering us a good base then. Obviously, we're still looking at maybe acquiring more company, but it needs to meet our criteria in term of quality and brand.

Robin Margaret Farley - *UBS Investment Bank, Research Division - MD and Research Analyst*

Okay, great. And then if I could just squeeze in one quick one on the ORV market. it sounds like July ORV sales accelerated from, sort of, April, May, June levels. Has that continued through August so far?

José Boisjoli - *BRP Inc. - President, CEO & Director*

Momentum -- obviously, the fall is always a bit influenced by program. I would say this year on offroad, the program are slightly less than last year, but the momentum of the industry and our momentum is continuing.

Operator

And the next question is from Gerrick Johnson with BMO Capital.



Gerrick Luke Johnson - *BMO Capital Markets Equity Research - Senior Toys and Leisure Analyst*

I have a couple here. Of the 3 new platforms that you've used to attack the white space out there in the side-by-side market, the Defender, X3 and the Trail, can you talk about where you are right now in dealer penetration for each, sort of like, Defender, say, you're 3 quarters of the way there or something in that context? And then also in the Marine segment, will you be showing us the intercompany sales of Evinrude to the Boat group?

José Boisjoli - *BRP Inc. - President, CEO & Director*

I'll take the first one, Gerrick, and Sebastien will take the second one. On the side-by-side segment, obviously, we are very aggressive on the sport category with the X3, the Maverick Trail and now with the Maverick Sport, and we filling a lot of space into the sports segment of the industry. The Defender, the utility is new for us. We're very happy with the momentum of the Defender retail. Quarter after quarter, we see our numbers and unit growing, but there is also more thing we can do in that segment as long as we continue to penetrate that segment. This is totally new for us. It's new for many of our dealers and us, and there is more opportunity there than in the sports segment in terms of continuing growing.

Sebastien Martel - *BRP Inc. - CFO*

On your second question, Gerrick, the way we do the reporting, we'll have 2 segments, we'll have the Powersports segment and you'll see that in our notes to the financial statements, and we'll also have a Marine segment. So within that Marine segment, you will have the selling of the engines and the selling of the boats. And so there is no intercompany profit elimination that's going to be happening there or sales elimination. However, our objective is to increase penetration within Alumacraft and within Manitou. And occasionally, we'll be updating you guys on how that conversion is going. Manitou today has about 40% of attachment rate of Evinrude engines, and Alumacraft is below 10%. And so we'll be obviously updating you occasionally on this.

Operator

The next question is from Greg Badishkanian with Citi.

Frederick Charles Wightman - *Citigroup Inc, Research Division - Senior Associate*

It's actually Fred Wightman on for Greg. So I understand there are still a lot of moving parts, but could you maybe just share some higher-level thoughts on the trade negotiations that are going on today as far as NAFTA, Canada and Mexico and what that could mean for you guys going forward?

Sebastien Martel - *BRP Inc. - CFO*

Yes, obviously, it's been a recurring topic, as you would know, and this week has been a very active week on the trade front, which is positive because things are moving ahead, and it's removing ambiguity. NAFTA still stands today, as you all know. However, what was tabled earlier this week, Monday, was an agreement between -- or Tuesday was an agreement between U.S. and Mexico. So it's a bilateral agreement. Very focused on the auto industry. And so when you look at the powersport industry, which product categories fall under what was announced earlier this week, it's the ATV product line, which is being impacted. They've also indicated that regional value content, or RVC, would increase and depending on the component or the part from 65% to 75%. Today, ATVs in order for them to be NAFTA compliant, they need to have 62.5% of the parts of NAFTA origin. And so that increases the level of compliance. So the teams will be doing assessments once the final regulations are out as to what the action plan is, whether or not compliance is feasible or not. But the good news, bad news is for us, ATV business, the transaction value between Mexico and U.S. is a little over \$200 million. And so if you're not in compliance and, again, I'm not saying that, that is our intention, but we'll refine our plans, if you are not in compliance, the total penalty would be in excess of \$5 million. So it's obviously something we can manage through. But we'll also look to minimize that impact either through the ability to comply or looking at various sourcing strategies with a more Asian sourcing strategy, which will compensate any penalties we might have.

Frederick Charles Wightman - *Citigroup Inc, Research Division - Senior Associate*

Great, that's really helpful. And then I think you guys had mentioned \$25 million in cost headwinds that you were expecting or potentially looking at for next year. Can you just talk a little bit about what's baked into that number? Is it really just changes in commodities? Or is there some other stuff that you're including there?

Sebastien Martel - *BRP Inc. - CFO*

Yes, the 2 big -- there's 3 elements. But the 2 big ones are commodities, which accounts for almost 60% of that amount. And the other one is freight. I mean, we've seen freight costs increase significantly this year. Demand for truckers is high. Demand for flatbeds, for closed boxes as well is high. And that puts a pressure on all of the industry and all of the trucking industry. And that's another element, which we factored. And yes, the other component, which is minor is tariffs. It's not extremely significant, but still impacting our business. And so that's built into that \$25 million.

Operator

The next question is from Mark Petrie with CIBC.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Just wanted to come back to the Marine division and wonder if you could just sort of comment about the industry at large. Obviously, it's had some nice growth over the last number of years, sort of rebounding from a tough period following financial crisis. But could you just talk about, sort of, the performance over the course of time? And then any comment about the used inventory today? And how you are, sort of, thinking about that?

José Boisjoli - *BRP Inc. - President, CEO & Director*

Obviously, we're not specialists yet on those product category, and you might find that funny, but Alumacraft is building a lot of small boats that are sold without engine, and we need to define with them, with the management what we consider powerboat and not powerboat. But just to give you a sense for the U.S. market, pontoon and aluminum fishing represent about 60% of an industry in U.S. of about 175,000 unit. Then, we entering with those 2 brand in a big portion of the industry, our reading for H1 for the industry and our 2 brand is the industry and the 2 brand have raised about mid-single digit. Then the industry is very healthy. It had very, very good momentum in the last few years. Q1 was a bit affected by also the bad weather in April, but it turned pretty good in the Q2. But overall, very happy with those acquisition because it's a big market. Like Sebastien mentioned, Alumacraft is rigged with about 10% only of Evinrude engine and Manitou about 40%. Then there is a lot of leeway to grow market share, but also to increase the Evinrude conversion going forward.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Okay. And could you just comment about, sort of, the evolution of used inventory in the industry? And how important that is an element in terms of expectations for industry health and, sort of, growth going forward?

Sebastien Martel - *BRP Inc. - CFO*

Yes, maybe I'll comment, Mark. Obviously, the industry was very focused on used probably 10 years ago out of the recession, but the trend that we're seeing is new boat sales are up positively and that trend has been continuing. And that the increase in the overall interest in Marine, we're seeing it as well in watercraft. So yes, there is a used boat market out there like any industry, but the demand for new boats is there, and we don't see it stopping in the short term. And that's why for us, an acquisition in the boat industry was logical.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Got it. And then just one, if I could, on the seasonality through the course of this year. Q2 in terms of, sort of, contribution to the total annual EBITDA, looks like it's substantially higher than what you guys have delivered in years past. How much of that is, sort of, the change in accounting impact, the IFRS 15 and 9? And how much is just, sort of, a change in your business? And just how should we, sort of, think about that, I guess?

Sebastien Martel - *BRP Inc. - CFO*

Well, the first thing -- the number -- under IFRS 15 change in accounting, last year numbers are restated as well. So there is 0 impact coming from changes in accounting. If you see the growth in gross margin at 210 basis points, that's the big driver of profitability increase. And the 2 main elements on the increase in gross margin, volume drives 150 basis points of margin improvement and mix and pricing as well about 220 basis points. The mix is -- continues to be rich on watercraft, as José talked to about. The new platform we launched last year is extremely well received, and the demand for that product is strong. And that's where we've gained market share. And that's a very mix -- very rich mix. Side-by-side continues to be rich as well in terms of mix with the Defender and the Maverick X3. And snowmobile as well, the units that we delivered this quarter were the higher-end models and that drove profitability upward as well.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

So I guess -- sorry, just to follow up, I mean, I guess, bigger picture, there are no reason to think that the sort of seasonality of the business is such that you could have 20% of annual EBITDA coming in Q2, something like that?

Sebastien Martel - *BRP Inc. - CFO*

We -- with side-by-side growing, the annual -- the weight of Q2 should increase in terms of EBITDA contribution progressively, yes.

Operator

The next question is from Craig Kennison with Baird.

Craig R. Kennison - *Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst*

My question has to do with Evinrude capacity. Given the incremental demand you may see from Alumacraft and Manitou, what will you need to invest in capacity at Evinrude to supply that?

José Boisjoli - *BRP Inc. - President, CEO & Director*

First, you know before those acquisition, and we said it very often, the Evinrude was very good to sell on the repower business, but that industry has shrink year-over-year. And right now, we are in the middle of the transition between G1 and G2, but the G2 transition will be finished in the next 18 months. And after, the layout in the factory will be a lot simplify, less complex for the operation, and we believe we could probably double our volume with minimum investment. Some equipment here and there, but we have plenty of capacity inserted.

Craig R. Kennison - Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst

That helps a lot. And then you had mentioned that Evinrude is on maybe 40% of your pontoon platform and under 10% of your aluminum fishing boat platform. Have you done any work to understand that customer base? To what extent does your Alumacraft customer, for example, have an engine preference? And if there is little preference there, could that number approach 100% over time?

José Boisjoli - BRP Inc. - President, CEO & Director

Yes, that's a very interesting question. It's always the same debate. Is the customer shop for a boat or customer shop for the engine? And we believe that the majority of the customer shop for a boat. The engine is important for maybe 20% of the consumer. But typically, the customer -- consumer decide of the boat, visit the dealer and with the dealer decide which engine, which power he will buy. And that's why it's always the same discussion we had. Is it the tail driving the dog or the other way around? And we were at the point with the repower business shrinking so much that we needed to enter the boat business to unlock. And we believe that by offering integrated product engine and boat from the factory, we have -- first, it will be better quality product for the dealers and the consumers, but also will make the choice easier for the consumer.

Operator

The next question is from Martin Landry with GMP Securities.

Martin Landry - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

On your 2 brands of Alumacraft and Manitou, wondering where is the -- what's the geographic breakdown of sales? Is that mostly North American?

José Boisjoli - BRP Inc. - President, CEO & Director

That's only North America, mainly Midwest.

Martin Landry - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Okay. And is there a potential to expand these products internationally or that would be challenging?

José Boisjoli - BRP Inc. - President, CEO & Director

There is. We already have some requests from other country that there is interest for those type of boat. The difficulty to ship outside North America is the cost, but it's something that we'll definitely look at. But it's probably more a midterm, long-term play than short term.

Martin Landry - GMP Securities L.P., Research Division - MD Equity Research & Equity Research Analyst

Okay. And my last question is on Spyder. You had a good retail sale performance during the quarter, I think it was up low teens. Was this a rebound from delayed purchases in Q1 due to the harsh weather? Or is this, you think, a sustainable trend?

José Boisjoli - BRP Inc. - President, CEO & Director

No, what happened, Mark, there was a delay because of weather also. Like we've said in Q1, retail was affected by the availability of some model with the new cluster, the new gauge. And this resolved in Q2. Also the other thing, when we saw the slow start in the spring, we've launched some



programs earlier than typical, maybe a month earlier than typical. Then the combination of the incredible summer we had and the program launch earlier picked up in Q2.

Operator

The next question is from Jean-Francois Lavoie with Desjardins Capital.

Jean-Francois Lavoie - *Desjardins Securities Inc., Research Division - Associate*

So I was wondering if you could provide an update on how you feel about your position in the Spyder market, especially ahead of the introduction of the project, please.

José Boisjoli - *BRP Inc. - President, CEO & Director*

Obviously, there is a lot of hype around the small Spyder that is coming. We're happy. We -- 2 years ago, we had too much inventory, and we depleted the inventory in the last 2 years. Then the inventory level is pretty comfortable in North America. There is pocket here and there, but overall, we're happy with the inventory level we have. And this, with just before the introduction of the entry-level Spyder is very promising. And don't forget, our strategy is to repeat what was done with the Spark with watercraft. The Spark has generated a lot of interest, bring a lot of new customers into the store. And many customer who came in for our Spark were upsold to a high-end watercraft. And since the introduction of the Spark, the market grew, I think, 65%, 70%. Now the -- we believe the same thing. We believe that, first, the price is the biggest barrier for purchase. That's why the used is so popular right now. And if you look, the price of the used is very high. And we believe by arriving with a family of product below USD 10,000, it will bring new customers, help the high-end RT and X3 lineup, but also bring lot of the height into the 3-wheel vehicle business. Then, very, very upbeat. The inventory is at a good level and very enthusiast about what we'll launch in a few days.

Jean-Francois Lavoie - *Desjardins Securities Inc., Research Division - Associate*

Great. And maybe if you could provide an update on the initiative for drive -- increasing the numbers of drivers in this segment.

José Boisjoli - *BRP Inc. - President, CEO & Director*

Yes. We -- it's going quite well. We have opened in North America right now, and I'm going by memory, but over 125 schools so far, and we'll give you some update in a few days when we are in Denver. But we definitely have very good momentum there. The take rate of the people taking the class is good. Then we feel good, and it's part of the strategy. Obviously, the small Spyder will generate a lot of hype, but we need to facilitate the training for the consumer. Then it's coming together. Very happy about signing over 125 schools so far, and we targeting more to come in the back half, before the end of 2018, but it's coming together.

Jean-Francois Lavoie - *Desjardins Securities Inc., Research Division - Associate*

Great. And maybe lastly for me. You mentioned that the performance of the PWC market in the higher end of this segment. I was curious to know a little bit more about the lower-end market with the Spark. How is the growth performing so far in this segment?

José Boisjoli - *BRP Inc. - President, CEO & Director*

Yes, first, this year, the -- just to give you a sense, these -- the luxury high end is about 1/3 of the industry, the mid-range recreational is 1/3 and the Spark category is 1/3 of the industry. And we are slightly above last year for recreational and Spark, but luxury performance, we are over 30% versus last year. Then we've gained significant market share on the high end because of the new platform. I think, worldwide, we're sold out with the new



platform. That's why we're going to the club in few days. Very happy with our position, and very well positioned with the watercraft industry, I would say, worldwide.

Operator

The next question is from Jaime Katz with Morningstar.

Jaime M. Katz - *Morningstar Inc., Research Division - Equity Analyst*

So I'm curious about the gross margin of the Marine business. It looks like when you break it out, it's around mid-teen level. And given where we are in the cycle and the improvement that these manufacturers have had, I'm curious where you think that might be able to get to over the next few years. And what sort of growth is implied in the top line to boost the gross margins?

Sebastien Martel - *BRP Inc. - CFO*

Yes, obviously, when you compare the 2 businesses, the Marine business margin is lower than our Powersport business. This quarter was a bit tougher quarter in terms of wholesale and in terms of production. And so that impacted the margins this quarter. As José said, we have capacity in the plant to easily double production, and so we're not running at full efficiency for that business. And so the long-term prospect for that business is obviously to increase margins. On the engine side, margins can come to where the Powersport business is. On the boat side, boat margins industry-wide are lower probably, I would say, 500 to -- let's say, 5% to 10% lower than the powersport industry, depending on boat segment. However, they have got lower operating costs in terms of overhead and lower CapEx investment, and they still delivered good profitability. And so our target is to bring the engine business closer to the Powersport over the -- over our plan of buy, build and transform.

Jaime M. Katz - *Morningstar Inc., Research Division - Equity Analyst*

Okay. And then your full year guidance implies that there is some slowdown in the back half relative to the first half, and while the third quarter that you're lapping last year is pretty robust, the fourth quarter wasn't as great. And so I'm curious if there is anything that's giving you pause in the back half of the year, or if maybe you're just being cautious?

Sebastien Martel - *BRP Inc. - CFO*

No, obviously, we're still -- as I said, we're still going to be showing growth in the fourth quarter, but we are investing in OpEx. So the top line is going to be there in terms of growth, margin is going to be there as well. But in terms of operating expenses, we are investing more in the fourth quarter and the second half than last year. And that's what's going to slow down a bit the profitability growth versus the first half.

José Boisjoli - *BRP Inc. - President, CEO & Director*

Both of those have stability and tariff as factors.

Sebastien Martel - *BRP Inc. - CFO*

Yes.

Operator

The next question is from Cameron Doerksen with National Bank Financial.

Cameron Doerksen - *National Bank Financial, Inc., Research Division - Analyst*

I guess, just a couple of questions on the -- following up on the questions about the NAFTA or U.S.-Mexico deal and the impact on you guys. If I -- correct me if I'm wrong, but it sounds like only ATVs, as you understand it, are impacted?

Sebastien Martel - *BRP Inc. - CFO*

Yes, the -- oddly enough, ATVs fall under auto industry legislation for NAFTA. And what's been proposed between the U.S. and Mexican Government is auto industry vehicle qualifications. And so side-by-side, personal watercraft, that's all excluded from the current discussions. And they still -- I mean, NAFTA is still valid, and they still fall under NAFTA.

Cameron Doerksen - *National Bank Financial, Inc., Research Division - Analyst*

Okay. What about Spyder? Because I guess the new Spyder is going to be manufactured in Mexico.

Sebastien Martel - *BRP Inc. - CFO*

Spyder as well is going to fall under same category as side-by-side and personal watercraft.

Cameron Doerksen - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And I guess, any issues around -- because there's been, I guess, part of the deal has to do with certain percentage of auto industry jobs have to be at \$16 an hour minimum or something like that. Does that have any potential impact on your labor force there?

Sebastien Martel - *BRP Inc. - CFO*

Yes, well, that's again a -- so there will be regional value content and there will be a certain percentage of labor. So if you don't meet that, then you will -- you won't qualify for free trade and you will pay the penalty of 2.5%. There is still a lot of questions as to, okay, what is \$16 per hour? Is it the direct labor that goes into the manufacturing and assembly of the vehicle? Or it's also supervisory, management and even R&D costs that are associated with the development of the parts? So that's out there. It's still preliminary. But there is more information to come as to what is the definition of a labor cost at \$16 an hour.

Cameron Doerksen - *National Bank Financial, Inc., Research Division - Analyst*

Okay, very good. Just a second question, I guess, maybe bigger picture on M&A. I mean, you guys filed a \$2.5 billion shelf prospectus last week. I'm just wondering what we should read into that, and what your sort of bigger picture plan is for M&A. Obviously, you've got some potential plans to do additional boatbuilding acquisitions, but are you still, sort of, thinking about something of a larger scale that's perhaps a new product line for BRP?



Sebastien Martel - *BRP Inc. - CFO*

Well, I'll break that question into 2 parts. The first part, filing the shelf prospectus is something that a lot of Canadian companies do and we've -- every time we've had secondary offerings, we've needed to file a prospectus every time. And so by having a shelf, that will facilitate future offerings that our major shareholders might want to do to the market. And that's the primary purpose why we did the shelf. On the M&A side, as José has alluded to in the past, I mean, we are open to M&A, and we'll do the acquisitions which make sense to us. We do have the balance sheet and the flexibility to do it. And so that is still out there. But it's not because we filed that shelf prospectus that we have an intention of closing a material transaction in the next few months.

Operator

The next question is from Tim Conder with Wells Fargo Securities.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

A couple here. Just wanted to follow-up -- just wanted to clarify. Are you looking, if we heard right, to consolidate some of the dealer networks on the Alumacraft and Manitou acquisitions?

José Boisjoli - *BRP Inc. - President, CEO & Director*

I don't think consolidate is the right word, but there is a lot of -- when you look -- when you map the 1,000 dealers that we have with Evinrude East to West, South to North in North America, there is a lot of opportunities for Evinrude dealers who are not carrying Evinrude or Alumacraft to take over the line in open area market. There is some dealers that might decide to stop selling our boat because we have -- we will promote more Evinrude. Then there is a lot of optimization to be done with the dealer network. It will take probably a year, 1.5 years to see what the dealer will do and to open up new dealers. But this is definitely something that we believe will have a lot of benefit for both company and Evinrude, I would say, midterm.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Okay, okay. And then you've talked about it several times what you've done, what you're coming up doing with Spyder, what you've done in personal watercraft. And the boat acquisitions are -- appear to be obviously a transom strategy also after admittedly good brands that you acquired. But some of the step up in expense, it just seems the technology of Evinrude relative to other major multiple competitors with 4 stroke, 6 cylinder, 8 cylinders types of things also being introduced. Should we anticipate a quantum leap at some point here? Is that part of the broad strategy?

José Boisjoli - *BRP Inc. - President, CEO & Director*

I would say that first -- like I said this morning to another question, a lot of customers shop the boat first and second the engine. Not all of them, but most of them. And many customer don't even understand the difference between 2-stroke and 4-stroke, it's the dealer who sometime -- most of the time influence them. And we believe that with 2-stroke, we have an incredible technology that is cleaner in many aspects than the 4-stroke. And we believe -- and that's part of the transform play, we believe that we can do a better integration of the engine and the boat if we design and engineer them together. And that will be a long-term play. But we have some idea to really make a good integration of the package that we believe will make a difference for the consumer.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Okay, okay. And then just maybe one other clarification, Sebastien. Did you say for fiscal '19, the marine contribution would be about \$0.10 in EPS?

Sebastien Martel - *BRP Inc. - CFO*

No, for next year.

José Boisjoli - *BRP Inc. - President, CEO & Director*

'20.

Timothy Andrew Conder - *Wells Fargo Securities, LLC, Research Division - MD and Senior Leisure Analyst*

Okay. And neutral in fiscal '19?

Sebastien Martel - *BRP Inc. - CFO*

That's correct.

Operator

The next question is from Derek Dley with Canaccord Genuity.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst*

Just quickly wanted to follow-up on your commentary around potential M&A and acquisitions. Where would you be comfortable taking your leverage level to complete a larger scale acquisition?

Sebastien Martel - *BRP Inc. - CFO*

Well, pro forma after the Manitou acquisition, which will be recorded in Q3, our leverage will be about 2x net debt. When we IPO-ed, we were at 3x leverage and that's some place where we were very comfortable operating at. And so we have that flexibility of -- and for me, what I've always said is making sure you have, one, a credit facility that is covenant light, and that's what we have today, making sure you have a facility as well that matures with a long-term horizon, and that's what we have today. And so could we go higher than 3 if the acquisition was super-attractive, well, that's a discussion we'd have with the board, but I wouldn't exclude it from our -- from the possibility.

Derek Dley - *Canaccord Genuity Limited, Research Division - MD & Consumer Products Analyst*

Okay. On your inventory position heading into the back half of the year, you mentioned it's up 7%. It looks like it's very clean. In terms of the combination of your inventory and then lower promotional activity within, at least the Year-Round Product space, how comfortable are you and what's, sort of, the visibility that you have on the promotional environment going forward outside of your realm? Like, are you seeing more promotional environment on snowmobiles at all? Or is everything looking pretty manageable at this point?

Sebastien Martel - *BRP Inc. - CFO*

Snowmobile, it's always a bit tougher to call. We know that's some OEMs have a bit of noncurrent inventory out there, so we expect noncurrent inventory to be promoted quite heavily. But again, the current models is very dependent on snow. And so we always plan for a normal snow season. And if the snow is there, then good, probably less promotional. If it's a bit tougher and it takes a bit of a time before the white stuff gets on the

ground, then we might have to put a bit more programs to work to get the retail moving. But in terms of overall inventory position, as we said, Q2 we're comfortable. My outlook for the end of the year is probably inventory up year-over-year, probably in the high single digits with SSV continuing to grow, personal watercraft as well is going to continue to grow, and we might have a bit more snowmobile inventory as well.

Operator

(Operator Instructions) The next question is from Seth Woolf with Northcoast Research.

Seth Woolf - *Northcoast Research Partners, LLC - VP & Research Analyst*

Just wanted to touch on 2 topics, the Year-Round Products and then the new, what you guys are doing in the boat space. So first, when we look at the side-by-side business, you had a peer in the powersports business last month. Your quarters don't overlap exactly, but they said that the market was up -- or they said it was flat and now your -- if we kind of look at what you guys are seeing now, it would imply that the market is up much more than that, probably mid-single digits. So I was just wondering if dig in those numbers, is it just a function of the different layout of your quarters? Or is there something else going on? Trying to understand how that could be so different.

José Boisjoli - *BRP Inc. - President, CEO & Director*

Yes. There is one element that may be influencing this. You know all the OEM announced their new lineup June, July. And at that time, noncurrent program for the model year '18, like everyone had announced their '19 models. And there is program right now going on, on '18. And you always have a lift of retail in the back end of our Q2 and the beginning of their Q3. That could influence. Also don't forget they had April in their quarter, which was a bad month because of the weather. And I will say that's the 2 things that I believe could influence the data.

Seth Woolf - *Northcoast Research Partners, LLC - VP & Research Analyst*

Okay. And then just kind of piggybacking off of that, I noticed when you guys make your estimates, you continue to significantly outperform the industry, but that outperformance, did that spread contracted quite a bit from 1Q to 2Q. Do you think that's largely a reflection of the programs that other OEMs are running in July? Or is there something else going on there?

Sebastien Martel - *BRP Inc. - CFO*

Well, obviously, we've had good -- we had good retail as well in Q2. The industry grew, so that's another good thing. But our retail quarter-over-quarter was still very strong. Obviously, are we expecting that retail growth to continue on side-by-side? We'd like for it, but we're realistic in the fact that, yes, we've entered into a lot of dealerships, we've launched a lot of new products. And so our expectation is that there is going to be a slowdown in the retail growth as we take our place in the industry and as we take our place in the dealerships as well.

Seth Woolf - *Northcoast Research Partners, LLC - VP & Research Analyst*

Okay. Got it. And then José, if we could -- I know you talked about it at the beginning of the call with there is a lot of boatbuilders out there that are potentially for sale and one of the strategies shorter term is to continue to buy. And I think you've talked about attaining critical mass. So can you just maybe talk about what that looks like? How -- when do you -- how big do you think that, that segment needs to get before you feel comfortable saying that you've reached the critical mass to be a global power in this space?

José Boisjoli - BRP Inc. - President, CEO & Director

First, there is a lot of companies for sales out there, but we are very selective in what we're acquiring. As you can notice, Manitou and Alumacraft are both aluminum product where we have expertise. Their Evinrude content, 10% for Alumacraft, Manitou 40%, we can -- we have opportunity there. The dealer network, we see optimization that we could do midterm. Then we will definitely -- we continue to look, we are looking at opportunities, but we will be very selective to acquire the right brand and also that offer the synergies that we're looking for. Today, we are right now continuing looking at what is available out there. But again, very happy with those 2 brands, strong brands, a lot of the know-how, good product. And if we find the same type of company, we'll definitely look at it. Just to give you a time line, you can expect that we could continue in the next 12 months to look at the opportunities.

Operator

There are no further questions registered at this time. I would like to turn the meeting back over to Mr. Deschenese.

Philippe Deschenese

Great. Thank you. And thanks, everyone, for joining us this morning and for your interest in BRP. We look forward to speaking with you again on November 30 for our third quarter conference call. Thanks, again, everyone, and have a good day.

Operator

Thank you. The conference has now ended. Please disconnect your lines at this time, and we thank you for your participation.

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