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Marine Industry Executive Summary for Lenders

Welcome to the Recreational Marine Industry!

Over the past fifteen years the recreational marine industry has experienced growth in sales and in corresponding loan portfolios. In the past two years, this growth has slowed along with the overall economy and some of the existing lenders chose to exit the marine space for strategic reasons unrelated to the specific financial results of their marine portfolios. At this point, the available lending in the marine industry has shrunk to the point where demand significantly exceeds supply. As a result, interest rate spreads have increased dramatically and there are many compelling reasons to enter the recreational lending space.

While the industry has seen setbacks due to economic pressures, historical data shows that the recreational marine market will rebound and opportunities will present themselves. In this summary you will be provided with demographics on the boating industry, the boating consumer, boat dealers and boat manufacturers and discussion specific to commercial floor plan lending. In addition, this overview will provide you with some historical perspective to better reflect on what the future holds.

This paper is designed to give you an overview of the current opportunity in recreational lending. The National Marine Bankers Association (www.marinebankers.org) provides additional information and training specific to boat lending. Lenders and interested marine industry parties are invited to benefit from the NMBA Marine Lenders Workshop, the Annual Report (marine finance statistical data) and the Annual Industry Conference. The National Marine Manufacturers Association (www.nmma.org) provides public policy advocacy, marketing, quality assurance, and resources and data for the recreational boating industry. Please contact NMBA association manager, Bernice McArdle for any further questions or needs pertaining to the marine finance industry. She can be reached at (312) 946-6260 or bmcardle@nmma.org.

Marine Industry Executive Summary for Lenders

The Marine Marketplace

In today's busy lifestyle, Americans feel it is important to spend quality time with their families. Spending a weekend together and enjoying each other's company is what boating has been about. Whether it's water skiing or fishing with your children or cruising our nation's waterways with friends, boating remains one of the most popular recreational activities enjoyed today.

In 2007 one out of four adults went boating on one of the over 17 million boats in use.ⁱ Retail expenditures for boating reached a high of \$39.5 Billion in 2006 and had their second highest level in history at \$37.5 Billion in 2007.ⁱ

Florida ranks number one in total expenditures for new powerboats, motors, trailer and accessories followed by Texas, California, New York and North Carolina. The Great Lakes Region accounts for 26% of all registered boats in 2006.ⁱ Outboard boats are most popular, making up nearly two-thirds of all registered powerboats in 2006 with 95% of motorized boats being less than 26 feet in length.

| Retail Expenditures (in Millions) ¹ | | | | | |
|--|----------|----------|----------|----------|----------|
| | 2003 | 2004 | 2005 | 2006 | 2007 |
| New Boat Unit Sales | 295,500 | 307,900 | 306,000 | 291,900 | 267,300 |
| New Boat Retail Dollars | \$8,387 | \$9,006 | \$9,400 | \$9,577 | \$9,485 |
| Used Boat Retail Dollars | \$6,327 | \$6,794 | \$8,979 | \$9,483 | \$7,433 |
| Total | \$14,714 | \$15,800 | \$18,380 | \$19,061 | \$17,005 |

The Boat Buyer

The boater owner demographic is largely middle class. They are married, own their homes and three out of four of them have a household income less than \$100,000. These boat owners spend an average of 32 days (or 16 weekends) on the water.ⁱ

The demographics of the boat borrower have always been extremely attractive to lenders. Not only do boat loan portfolios perform satisfactorily, but the borrower can also be an excellent opportunity for cross-marketing other loan and/or deposit services. A few key demographics^{vii} reflect this:

- Average household income of \$115,000
 - \$134,000 for the inboard cruiser and larger sailboat owners
 - \$71,000 if personal watercraft statistics are included.

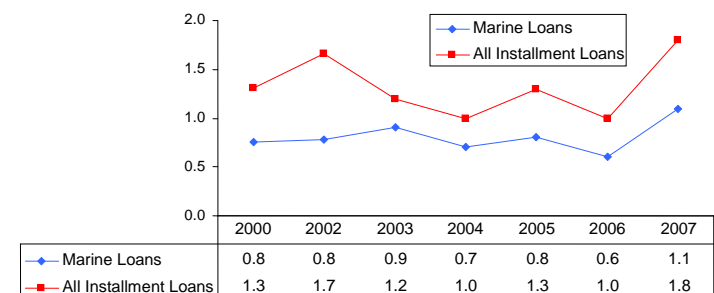


- Average age 45-49 years
- 68% of boat owners are married
- 90% own their homes
- 48% are managerial, executive, professional (70% for the inboard cruiser and larger sailboat owners)

The marine product, similar to other big ticket purchases, is directly impacted by swings in the economic climate. Recent market fluctuations have been no exception. Even with these cyclical market disruptions, the average marine borrower has performed well. Today's marine loan portfolios reflect the following characteristics:ⁱⁱⁱ

- Average boat loan amount \$143,600 (2007 statistic)
- Most portfolios contain a good mix of new (55%) versus used (45%) boats
- Although the majority of loans of \$25,000 and above have a term of 15 or 20 years, the average loan continues to pay off in 42 months
- Delinquency and charge off remain lower than other consumer loan portfolio types (See graphs below)

Average Delinquencyⁱⁱⁱ



The Boat Dealer

In order to support its sales numbers, the industry employs a large number of Americans. There were 1,136 active boat builders and 7,535 boat dealers employing 44,565 and 43,991 employees respectively in 2007.ⁱ

In 2006 the top five states for boat businesses, including boat builders, dealers and wholesalers were, Florida with 25,585 employees alone, California, New York, Tennessee and Michigan. In 2007, recreational boating directly and indirectly impacted 337,758 jobs with a labor income of \$10.4 Billion.ⁱ

Boating also has an international financial impact. Total boat and engine exports reached \$2.9 Billion while



Marine Industry Executive Summary for Lenders

imports reached \$2.5 Billion, resulting in a trade surplus of \$391 Million.ⁱ

Today's boat dealership is a small to mid-sized business that can provide new and used boat and motor sales, and service, storage and dockage. While the concentration of boat businesses is found on or near the water, smaller boat dealerships can be found in almost any geography.

Similar to auto and truck dealerships, boat dealers require significant inventory levels. Dealers build inventory during the winter months in anticipation of having a broad selection during the spring selling season. Fluctuations in inventories vary by geography and the type of boats the dealerships sells.

The average dealership will turn their inventory approximately two times per year. This inventory intensive business model reflects higher leverage ratios than found in typical middle market businesses. Debt is offset by strong working capital positions comprised by a larger percentage of inventories than other middle market businesses.

In the boat dealer segment there is a practice of bringing 20 similar dealers from non-competing markets together to share financial information, performance, and overall strategies to help each member dealer improve. These "20 Groups" often utilize specialty consulting firms such as The Spader Group. *Boating Industry* magazine publishes benchmark financial data provided by The Spader Group with averages of how their members perform on certain Key Performance Indicators.

| Key Performance Indicators ^{iv} | | | | |
|--|-------------|--------------|-------------|-------------|
| | 2008 | 2007 | 2006 | 2005 |
| Total Unit Sales | \$6,281,509 | \$8,899,472 | \$7,872,666 | \$7,285,842 |
| Service | \$786,574 | \$856,334 | \$764,228 | \$690,566 |
| Parts & Accessories | \$783,670 | \$818,599 | \$699,711 | \$633,559 |
| Finance and Insurance | \$101,728 | \$176,177 | \$152,132 | \$134,618 |
| Other Revenue | \$684,618 | \$776,226 | \$606,266 | \$659,891 |
| Total Revenue | \$8,479,887 | \$11,264,927 | \$9,903,306 | \$9,169,190 |
| Unit Sales Gross Margin | 16.90% | 17.70% | 17.90% | 18.60% |
| Total Gross Margin | 29.90% | 28.50% | 28.50% | 28.60% |
| New Boat Inventory | \$3,432,000 | \$3,666,648 | \$3,427,244 | \$2,756,622 |
| Used Boat Inventory | \$417,978 | \$383,087 | \$347,443 | \$284,193 |
| Net Profit | \$96,909 | \$283,405 | \$303,847 | \$311,771 |

For 2007 and 2008 fiscal year end periods, the average Spader Group member had a current ratio of 1.32 to 1, a

debt to worth of 2.67 to 1 and an inventory turnover of 1.7 times. These numbers reflect one point in time and a twelve month report provides a realistic view of what a dealers financial position should be through the seasons. This sampling of dealers reflects some of the highest performing businesses in the industry.

The Boat Manufacturer

The mass market recreational boating industry is relatively new, starting in the 1960's as fiberglass construction became viable. Prior to that time boating was largely an upper class sport with highly skilled craftsmen building water tight wooden hulled boats or yachts. Once fiberglass became available, boats could be built by less skilled, and less costly, labor and with more economical materials. This change in materials allowed boating to become an affordable middle class sport. Today's American boater is typically purchasing a boat built here in the USA. This is a point of pride in the industry as "Made in America" means so much to our nation.

While there are approximately 1,136 boat builders in the USA, the majority of boats are built by less than 250 builders. In many cases, builders band together inside of buying groups to increase their purchasing power. This helps them compete with larger builders that produce multiple brands.

Boat builders provide an integral piece of the industry that affects consumers, dealers and lenders. To the buyer they provide warranty support and are involved in much the same way a car manufacturer is today. To the dealership they provide marketing support, hire the dealership to perform the warranty work, and in many cases will pay for a portion of the floor plan interest to hold inventory.

To the lender, the builder's product, brand and support solidifies the value of the collateral on both floor plan and retail loans. In the case of commercial floor plan lines of credit, the builders provide a level of guarantor support that is covered later in this paper.

Boat builders have concerns similar to many other types of manufacturers. Effectively managing raw materials, work in process and personnel is the key to financial stability. The ability to produce a quality, state of the art product and marketing execution are the keys to success.

The Sales to Total Assets ratio measures a company's ability to generate sales in relation to total assets

Marine Industry Executive Summary for Lenders

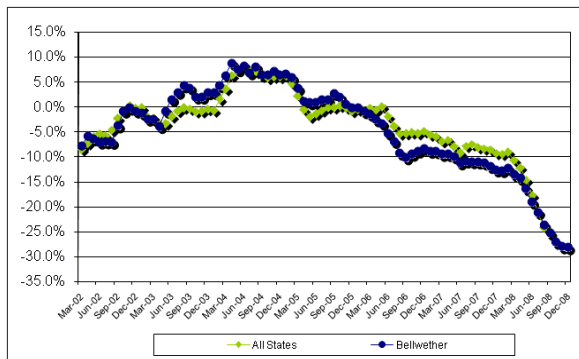
employed. A higher ratio indicates a more efficient use of assets.^v

| Sales to Total Assets ^v | | | | |
|------------------------------------|------|------|------|------|
| | 2003 | 2004 | 2005 | 2006 |
| Boat Builder Average | 2.7 | 3 | 2.7 | 3.3 |
| Discrete Average | 2.3 | 2.5 | 2.4 | 3.1 |

The “Discrete Average” is a benchmark of similar industries tracked by RSM McGladrey, Inc.

| Inventory Turns ^v | | | | |
|------------------------------|------|------|------|------|
| | 2003 | 2004 | 2005 | 2006 |
| Boat Builder Average | 15 | 16.5 | 16.3 | 14.9 |
| Discrete Average | 12.7 | 12.9 | 12.2 | 11.4 |

The industry actively tracks shipments and retail sales to better understand the marketplace. One of these tools is Info-Link Technologies Bellwether Report ^{vi}. The graph below tracks the year over year change in retail unit sales for all 15 foot and larger powerboats over a rolling 12 month period.



Bellwether states are geographically dispersed states representing roughly half of the US boat market (varies by market segment and time of year)

Historical Perspective

The recreational marine industry established itself in the 1960’s when boating became accessible to a larger audience with the introduction of fiberglass. This made

boatbuilding easier, faster and cheaper and created a new market place.

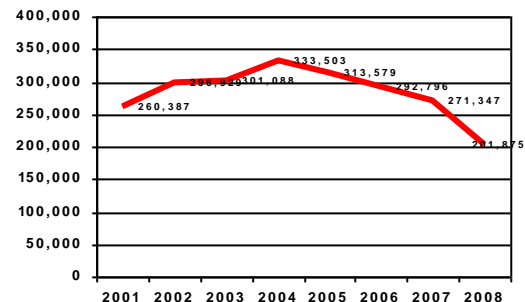
Since boat lending’s inception, the market has seen several highs and lows. Each economic cycle has seen the industry shrink and rebound with further growth while becoming more sophisticated. This increased business savvy is found not only in the production of the boats and motors, but in the financial tools available.

Just as predictive, there were periods where both retail and commercial lenders stuck to sound lending practices and were able to prosper in the recreational boating market. After the dot-com bust came to an end in 2001, lenders enjoyed increasing loan opportunities that allowed them to originate strong, profitable loans.

Commercial floor plan lenders also enjoyed this time of prosperity in the early 2000’s as their dealer clients that were strong enough to survive the recession of 1989 - 1991 and 2001 were now very strong and savvy. There were a number of national floor plan lenders, including banks and finance companies, which used sound commercial lending practices and prospered.

The graphs below provide a visual representation of how the industry rebounded from the 2001 recession, peaked in early 2005 and began to drop heading into the latest recession. This trend has repeated itself since the 1970’s through each economic cycle.

Manufacturer Shipments of Traditional Power Boats to Dealers ⁱⁱ



The most recent lessons have proven that retail consumer lenders that practiced no-doc lending, decreased credit standards with the idea that higher interest rates would cover risk, allowed low or no down payment loans and provided loans beyond collateral value will ultimately fail. Commercial floor plan lenders that continued to focus on working capital levels, inventory management and controlled leverage have been successful.

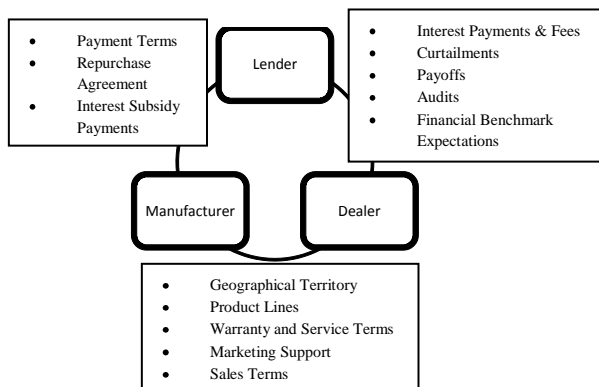
Marine Industry Executive Summary for Lenders

Even though there has been a history of ups and downs in the industry, sound lending practices provide solid returns over time. Each time these events replicate themselves; more lending opportunities emerge that are stronger and more profitable than before.

Commercial Floor Plan Lending in the Recreational Marine Industry

Commercial floor plan inventory lending has been popular as a means for dealerships to utilize leverage in order to have product available for the consumer to purchase. Many boat buyers desire immediate gratification once the purchase decision has been made and having product readily available can strongly influence the decision to buy. Dealerships also find floor plans allow them to stock a wider sample of boats from the manufacturers they represent.

In the boating industry, the prime selling season is March through July. Despite this, manufacturers need to spread production over twelve months to lower costs and retain their skilled workforce. Manufacturers often provide floor plan interest subsidies to the dealers during the winter as an incentive for dealer to accept stock throughout the entire year. Therefore, commercial floor plan inventory lending benefits both manufacturers and dealerships.



The relationship between the lender, the dealership and the manufacturer provides a balance of risk and responsibility by each of the parties involved. The diagram above provides a visual representation and overview of this relationship. When each party works in unison with the other two, business is able to flow and risks are kept to a minimum.

When providing financing to a boat dealer, the specifics of the relationship between the lender and the dealership are spelled out in the term letter and note and security agreement. These terms include:

- **Interest Rate and Fees:** Floor plan lines of credit are typically floating based on the Prime rate or LIBOR (London InterBank Offered Rates) and include administrative and audit fees.
- **Curtailment Schedule:** In the event that a boat is not sold within a specific period of time, the lender collects principle reduction payments from the dealership.
- **Sold Boat Payoffs:** Standard industry practice dictates that when a boat is sold and the funds are with the dealer, that the unit will be paid off within 3 days.
- **Audits:** Lenders take a physical inventory of product on hand versus the floor plan detail and also review the paperwork on units recently sold.

While the primary relationship is between the dealership and the lender, the manufacturer holds a key component in the relationship with the lender. Terms are included as part of the overall term agreement or may be found in the repurchase / remarketing agreements:

- **Payment Terms:** This dictates the number of days between receipt of an invoice and when the lender pays the manufacturer on behalf of the dealership.
- **Interest Subsidy Terms:** In the event that the manufacturer pays the interest on behalf of the dealership for a period of time, this will dictate the rate and payment terms.
- **Repurchase / Remarketing Agreement:** In the event of a dealer default, the manufacturer agrees to either repurchase the product from the lender or assist in its sale for liquidation. Variables include inventory age and condition of the boats.

The dealership and the manufacturer have an agreement that details the points of their relationship. From a lender point of view it is important to understand how freight will be paid, what discounts are realized on the invoices and if and what interest subsidy will be paid.

In commercial floor plan lending there are unique lending risks and effective methods to mitigate these risks. The practice of regular unscheduled inventory audits provides a great deal of information in managing these relationships in addition to standard financial statement reviews.

Marine Industry Executive Summary for Lenders

Today's recreational marine lending landscape is rich with opportunities. Due to recent fluctuations in the credit and capital markets the demand is greater than the supply for retail and commercial floor plan lenders. As a result the interest rate spreads have increased and the profit potential is at its pinnacle today.

As with any lending, there are inherent risks involved. By providing this information to better understand the boating industry the National Marine Bankers Association encourages lenders to become active in the industry and be part of the next expansion.

About NMBA

The National Marine Bankers Association (NMBA) marked its 30th Anniversary in 2009. It was created, and continues today, to educate current and prospective lenders in marine financing procedures, promote the extension of credit to consumer and trade borrowers, maintain alliances with industry partners, measure and report on the vitality of the marine lending market, and actively maintain networking and communication benefits for its members.

If you represent a financial institution interested in joining the NMBA or want more information, please call our offices at 312/946-6260 or visit our website at www.marinebankers.org.

About NMMA

National Marine Manufacturers Association (NMMA) is the leading association representing the recreational boating industry. NMMA member companies produce more than 80 percent of the boats, engines, trailers, accessories and gear used by boaters in the United States. The association is dedicated to industry growth through programs in public policy, market research and data, product quality assurance and marketing communications. They can be reached at (312) 946-6200 or www.nmma.org & www.discoverboating.com.

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About the Author

Bill Thompson has been a leader in commercial and retail banking with 18 year of involvement in the marine and RV industries. He has expertise in developing and implementing lending programs for dealers and manufacturers. He is a long-time member of the NMBA and currently is an industry consultant operating Cardinal Points Network, LLC at www.cardinalpointsnetwork.com or can be reached at 216-496-9481.

ⁱ 2007 NMMA Recreational Boating Statistical Abstract www.nmma.org/facts

ⁱⁱ *Boating Industry* – Market Data Book 2008 www.boating-industry.com

ⁱⁱⁱ 2007 NMBA Lenders Survey (Available at www.marinebankers.org.)

^{iv} Spader Key Performance Indicators provided by The Spader Group as published monthly in *Boating Industry* magazine. (Additional performance indicators available directly from The Spader Group at www.spader.com or 800-772-3377)

^v 2007 NMMA Recreational Boating Statistical Abstract source RSM McGladrey, Inc. www.rsmmcgladrey.com

^{vi} Based on data from Info-Link and Statistical Surveys on new US boat registrations. www.info-link.com/bellwetherreport.asp

^{vii} Demographics and Loan Statistics www.nmma.org website “Boating Statistics-Challenges and Opportunities-Facts and Figures” May, 2008