Malibu Boats, Inc.
Form 10-K
September 09, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2016
Commission file number: 001-36290

MALIBU BOATS, INC.
(Exact Name of Registrant as specified in its charter)

Delaware	5075 Kimberly Way Loudon, Tennessee 37774	46-4024640
(State or other jurisdiction of incorporation or organization)	(Address of principal executive offices, including zip code)	(I.R.S. Employer Identification No.)
	(865) 458-5478	
	(Registrant's telephone number, including area code)	

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common Stock ($0.01 par value per share)	NASDAQ Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No þ
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ¨ Accelerated filer þ Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
As of December 31, 2015, the last business day of the registrant’s most recently completed second fiscal quarter, the aggregate value of the registrant’s common stock held by non-affiliates was approximately $261.0 million, based on the number of shares of Class A common stock held by non-affiliates as of December 31, 2015 and the closing price

of the registrant's Class A common stock on the NASDAQ Global Select Market on December 31, 2015. Shares held by each executive officer, director and by each person who owns 10% or more of the outstanding Class A common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. The number of outstanding shares of the registrant's Class A common stock, par value $0.01 per share, and Class B common stock, par value $0.01, as of September 8, 2016 was 17,696,693 and 23, respectively.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the 2016 Annual Meeting of Stockholders are incorporated into Part III of this Annual Report on Form 10-K where indicated. Such proxy statement will be filed with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended June 30, 2016.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements. All statements other than statements of historical facts contained in this Form 10-K are forward-looking statements, including statements regarding our future financial position, sources of revenue, demand for our products, our strengths, business strategy and plans, prospective products or products under development, costs, timing and likelihood of success, gross margins, non-GAAP financial measures and management’s objectives for future operations. In particular, many of the statements under the headings “Item 1A. Risk Factors,” “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Item 1. Business” constitute forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “esti “predicts,” “potential,” “continue,” the negative of these terms, or by other similar expressions that convey uncertainty of future events or outcomes to identify these forward-looking statements. These statements are only predictions, involving known and unknown risks, uncertainties and other factors that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Such factors include general economic conditions; significant fluctuations in our annual and quarterly financial results; unfavorable weather conditions; our reliance on our network of independent dealers and increasing competition for dealers; the financial health of our dealers and their continued access to financing; our obligation to repurchase inventory of certain dealers; our failure to manage our manufacturing levels while addressing the seasonal retail pattern for our products; our large fixed cost base; intense competition within our industry; increased consumer preference for used boats or the supply of new boats by competitors in excess of demand; the successful introduction of new products; competition with other activities for consumers’ scarce leisure time; the continued strength of our brands; our ability to execute our manufacturing strategy successfully; our ability to meet our manufacturing workforce needs; our reliance on third-party suppliers and ability to obtain adequate raw materials and components; our exposure to claims for product liability and warranty claims; our dependence on key personnel; our ability to grow our business through acquisitions or strategic alliances and new partnerships; our growth strategy which may require us to secure significant additional capital; our ability to protect our intellectual property; disruptions to our network and information systems; exposure to workers' compensation claims and other workplace liabilities; risks inherent in operating in foreign jurisdictions; changes in currency exchange rates; an increase in energy and fuel costs; any failure to comply with laws and regulations including environmental and other regulatory requirements; a natural disaster or other disruption at our manufacturing facilities; increases in income tax rates or changes in income tax laws; covenants in our credit facilities which may limit our operating flexibility; our variable rate indebtedness which subjects us to interest rate risk; our status as an “emerging growth company”; and any failure to maintain effective internal control over financial reporting or disclosure controls or procedures.

We discuss many of these factors, risks and uncertainties in greater detail under the heading “Item 1A. Risk Factors” and elsewhere in this Form 10-K. These factors expressly qualify as forward-looking statements attributable to us or persons acting on our behalf.

You should not rely on forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Actual results may differ materially from those suggested by the forward-looking statements for various reasons, including those discussed under “Item 1A. Risk Factors” in this Form 10-K. Except as required by law, we assume no obligation to update forward-looking statements for any reason after the date of this Form 10-K to conform these statements to actual results or to changes in our expectations.

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PART I.

Item 1. Business

Unless otherwise expressly indicated or the context otherwise requires, in this Annual Report on Form 10-K:

- we use the terms “Malibu Boats,” the “Company,” “we,” “us,” “our” or similar references to refer (1) prior to the consummatio of our initial public offering on February 5, 2014, or IPO, to Malibu Boats Holdings, LLC, or the LLC, and its consolidated subsidiaries and (2) after the IPO, to Malibu Boats, Inc. and its consolidated subsidiaries;
- we refer to the owners of membership interests in the LLC immediately prior to the consummation of the IPO, collectively, as our “pre-IPO owners”;
- we refer to owners of membership interests in the LLC (the "LLC Units"), collectively, as our “LLC members”;
- references to “fiscal year” refer to the fiscal year of Malibu Boats, which ends on June 30. Fiscal years 2012 and 2013 for the LLC ended on June 30, 2012 and 2013, respectively. Fiscal years 2014, 2015 and 2016 ended on June 30, 2014, 2015, and 2016, respectively;
- we use the term “performance sport boat category” to refer to our industry category, primarily consisting of fiberglass boats equipped with inboard propulsion and ranging from 19 feet to 26 feet in length, which we believe most closely corresponds to (1) the inboard ski/wakeboard category, as defined and tracked by the National Marine Manufacturers Association, or NMMA, and (2) the inboard skiboat category, as defined and tracked by Statistical Surveys, Inc., or SSI; and
- references to certain market and industry data presented in this Form 10-K are determined as follows: (1) U.S. boat sales and unit volume for the overall powerboat industry and any powerboat category during any calendar year are based on retail boat market data from the NMMA; (2) U.S. market share and unit volume for the overall powerboat industry and any powerboat category during any fiscal year ended June 30 or any calendar year ended December 31 are based on comparable same-state retail boat registration data from SSI, as reported by the 50 states for which data was available as of the date of this Form 10-K; and (3) market share among U.S. manufacturers of exports to international markets of boats in any powerboat category for any period is based on data from the Port Import Export Reporting Service, available through March 31, 2016, and excludes such data for Australia and New Zealand.

This Annual Report on Form 10-K includes our trademarks, such as “Surf Gate” and “Wakesetter,” which are protected under applicable intellectual property laws and are the property of Malibu Boats. This Form 10-K also contains trademarks, service marks, trade names and copyrights of other companies, which are the property of their respective owners. Solely for convenience, trademarks and trade names referred to in this Form 10-K may appear without the ® or TM symbols, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the right of the applicable licensor to these trademarks and trade names.

Our Company

We are a leading designer, manufacturer and marketer of performance sport boats, having the #1 market share position in the United States since 2010. Our boats are used for water sports, including water skiing, wakeboarding and wake surfing, as well as general recreational boating. Since inception in 1982, we believe we have been a consistent innovator in the powerboat industry, designing products that appeal to an expanding range of recreational boaters and water sports enthusiasts whose passion for boating and water sports is a key aspect of their lifestyle. We believe many of our innovations, such as our proprietary Surf Gate technology launched in 2012, expand the market for our products by introducing consumers to new and exciting recreational activities. We believe that our boats are increasingly versatile, allowing consumers to use them for a wide range of activities that enhance the experience of a day on the water with family and friends. While there is no guarantee that we will achieve market share growth in the future, we believe that the performance, quality, value and multi-purpose features of our boats position us to achieve our goal of increasing our market share in the expanding recreational boating market.

We sell our high performance boats under two brands-Malibu and Axis Wake Research, or Axis. Our flagship Malibu brand boats offer our latest innovations in performance, comfort and convenience, and are designed for consumers seeking a premium boating experience. Retail prices of our Malibu boats typically range from $40,000 to $175,000. We launched our Axis brand of boats in 2009 to appeal to consumers who desire a more affordable product but still demand high performance, functional simplicity and the option to upgrade key features. Retail prices of our Axis boats typically range from $45,000 to $95,000.

Our boats are constructed of fiberglass, equipped with inboard propulsion systems and available in a range of sizes and hull designs. We employ experienced product development and engineering teams that enable us to offer a range of models across each of our brands while consistently introducing innovative features in our product offerings. Our engineering team closely collaborates with our manufacturing personnel in order to improve product quality and process efficiencies. The results of this collaboration are reflected in our receipt of numerous industry awards, including the Watersports Industry Association's Innovation of the Year in 2010 and 2013.

We sell our boats through a dealer network that we believe is the strongest in the performance sport boat category. As of July 1, 2016, our distribution channel consisted of 110 independent dealers in North America operating in 147 locations in North America and we had 58 independent dealer locations across 38 countries outside of North America, including Australia. Our boats are the exclusive performance sport boats offered by the majority of our dealers. Additionally, we believe that our Australia segment is the largest performance sport boat manufacturer in that country. Our dealer base is an important part of our consumers' experience, our marketing efforts and our brands. We devote significant time and resources to find, develop and improve the performance of our dealers and believe our dealer network gives us a distinct competitive advantage.

Financial Information About Segments

We report our results of operations under two reportable segments called U.S. and Australia segments based on their respective manufacturing footprints. Each segment participates in the manufacturing, distribution, marketing and sale of performance sport boats. The U.S. operating segment primarily serves markets in North America, South America, Europe, and Asia while the Australia operating segment principally serves the Australian and New Zealand markets. The segment and geographic information required herein is contained in Note 18 - Segment Reporting, in the notes to our consolidated financial statements.

Our Market Opportunity

During calendar year 2015, retail sales of new powerboats in the United States totaled $7.8 billion. Of the powerboat categories defined and tracked by the NMMA, our core market corresponds most directly to the inboard ski/wakeboard category, which we refer to as the performance sport boat category. We believe our addressable market also includes similar and adjacent powerboat categories identified by the NMMA, which totaled over $5.6 billion of sales in 2015. The following table illustrates the size of our addressable market in units and retail sales for calendar year 2015:

Powerboat Category	Unit Sales	Retail Sales (Dollars in millions)
Outboard	155,800	$ 3,828
Sterndrive	12,900	924
Performance sport boat	7,800	686
Jet boat	4,400	208
Total addressable market	180,900	$ 5,646

We believe we are well-positioned to benefit from trends in our addressable market, including:

Improving Macroeconomic Environment Driving Increased Consumer Demand for Boats. Following the economic downturn, the recreational boating industry has grown and is projected to continue to recover. While domestic sales of new performance sport boats in 2015 grew to approximately 7,800 units, they remained 40% below the category's 2006 sales volume of 13,100. We believe there remains significant opportunity for growth from increased consumer demand in the recreational boating industry as the economy improves, but there are numerous variables that have potential to impact the growth to be achieved in the future,

Increasing Ages of Used Boats Driving New Boat Sales. In 2015, according to NMMA retail sales data, new powerboats accounted for approximately one out of five powerboat sales in the United States compared to an average of approximately one out of four between 2002 and 2008. We believe the shift toward purchasing more used boats during the economic downturn helped cause the average age of powerboats in use to increase from 15 years in 1997 to over 21 years today. As the powerboat industry continues its ongoing recovery and older boats reach the end of their usable lives, we expect consumer purchases of new boats to shift back toward historic levels benefiting new boat manufacturers.

Our Strengths

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#1 Market Share Position in Performance Sport Boat Category. According to SSI, we have held the number one market share position, based on unit volume, in the United States among manufacturers of performance sport boats for calendar years since 2010 including 2015. We have grown our U.S. market share from 23.3% in 2008, the year prior to the arrival of our current Chief Executive Officer and Chief Financial Officer, to 32.0% in 2015. The following table reflects our U.S. market share in the performance sport boat category compared to the market share of our competitors for the periods shown:

	U.S. Market Share in Performance Sport Boat Category							
Manufacturer/Brand(s)	2008	2009	2010	2011	2012	2013	2014	2015
Malibu Boats/Malibu and Axis	23.3 %	23.5 %	24.4 %	29.0 %	30.8 %	33.0 %	32.0 %	32.0 %
MasterCraft Boat Company, LLC/MasterCraft	24.1	25.1	23.3	23.9	21.8	20.0	20.5	21.7
Correct Craft, Inc./Nautique[1]	24.0	24.7	23.1	19.9	19.6	20.6	23.0	21.6
Skier's Choice, Inc./Supra and Moomba	16.7	15.6	16.7	15.6	14.7	12.6	12.0	12.8
All others	11.9	11.1	12.5	11.6	13.1	13.8	12.5	11.9
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

(1) In June 2015, Correct Craft acquired majority interest in both Centurion Boats and Supreme Boats. Accordingly, market share for Ski Supreme, Centurion, and Nautique are reflected combined here for all periods for better comparison.

In addition, our 53% market share of performance sport boat exports to international markets for the 12 months ended March 31, 2016 was the highest among U.S. manufacturers and was more than our top two competitors combined.

Performance Sport Boat Category Taking Share. As the recovery in the general economy and overall powerboat industry has continued, the performance sport boat category in which we participate has experienced one of the highest growth rates. New unit sales of performance sport boats in the United States increased by 16% from 2013 to 2014, while new unit sales of all other powerboats in the United States increased 6% over the same period. This trend continued in 2015, as new unit sales of performance sport boats and all other powerboats in the United States increased by 10% and 7%, respectively, for the year ended December 31, 2015. We believe this is largely attributable to increased innovation in the features, designs and layouts of performance sport boats, which has improved the performance, functionality and versatility of these boats versus other recreational powerboats, particularly the larger category of sterndrive boats. We believe that we have been at the forefront of product innovation and will continue to appeal to a broader consumer base that values our boats not only for water sports, but also for general recreational boating and leisure activities. We believe that our market-leading position within our expanding category will create continued growth opportunities for us.

Poised to Take Advantage of the Performance Sport Boat Market Recovery. With our leading and growing market share in our category, we believe that we are well-positioned to take advantage of the ongoing recovery in the powerboat market. While the performance sport boat category grew 10% in calendar year 2015, new unit sales still remain significantly below historical peaks. As illustrated in the chart below, the 7,800 new units sold in calendar year 2015 were 33% below the average annual new unit sales volume of 11,714 observed between 2001 and 2007 and 40% below the 13,100 new units sold in 2006. While there is no guarantee that the market will continue to grow or return to historical sales levels, we believe the continuing recovery in the performance sport boat market presents significant opportunity for growth.

Even if the performance sport boat market does not reach previous peak levels, we believe that our #1 market share position in a category that is growing faster than the overall powerboat industry, our investments in our business during and subsequent to the economic downturn, including the acquisition of our Australian licensee, vertical integration efforts related to manufacturing our own towers, trailers, and other products, and our innovative product offering should drive superior performance.

Industry-leading Product Design and Innovation. We believe that our innovation in the design of new boat models and new features has been a key to our success, helping us increase our market share within our category and generally broaden the appeal of our products among recreational boaters. As a result of the features we have introduced, we believe that our boats are used for an increasingly wide range of activities and are increasingly easier to use, while maintaining the high performance characteristics that consumers expect. Additionally, by introducing new boat models in a range of price points, sizes, bow and hull designs, and optional performance features, we have enhanced consumers' ability to select a boat suited to their individual preferences. Our commitment to, and consistency in, developing new boat models and introducing new features are reflected in several notable achievements, including:

- release of our patented Surf Gate technology in 2012, which allows users to surf on either side of the boat's wake, generates a better quality surf wave and was the Watersports Industry Association's Innovation of the Year in 2013;
- launch of the Axis brand of boats in 2009, designed from the ground up to be an entry-level product, which has already captured a 11.0% share of the U.S. market in our category as of December 31, 2015;
- introduction of the patented Power Wedge in 2006, which gives boaters the ability to customize the size and shape of the boat's wake with the push of a button. This was followed in 2014 with the Power Wedge II, which provides an even larger displacement and more control of wakes and waves than the original Power Wedge. It was integrated into our Integrated Surf Package to further provide a competitive advantage for wake surfing;
- introduction of the first Malibu designed and manufactured tower in 2009;

- integration of the manufacturing of our own trailers beginning with model year 2016, including full trailer design and construction which provides greater customization and quality control;
- a strong new product lineup for model year 2016 that included the launch of the Malibu M235, Wakesetter 25 LSV, the Wakesetter 20 VTX and Axis A20. In addition, on our model year 2016 products, we offered an improved Surf Gate system with hydraulic actuators, our patented rider controlled Surf Band technology, new windshields, new vinyl and backup cameras; and
- successful new model introductions each year. For model year 2017, we will launch four new models: the Malibu Wakesetter 24 MXZ, the Malibu Wakesetter 22 MXZ, and the Malibu Wakesetter 21 VLX were all launched in the summer of 2016 and an additional Malibu model will be launched this fall.

Intellectual Property. A key element of our growth and increased market share has been our intellectual property which we believe is the best in our industry. Among our most innovative and sought after features on our boats has been Surf Gate. Together with Power Wedge and Surf Band, these patented technologies continue to drive demand for our products and increased margins. We vigorously defend our patents and other intellectual property to ensure we maintain our competitive edge. Because of the appeal of these technologies, we have entered into agreements to license them to other manufacturers within the powerboat category. We believe licensing our products provides us with significant strategic advantage over our competitors by allowing us to expand into other markets and broadening the appeal of these technologies into segments that would not otherwise have them thereby eventually creating a path to Malibu.

Strong Dealer Network. We have worked diligently with our dealers to develop the strongest distribution network in the performance sport boat category. We believe that our distribution network of 147 North American dealer locations and 58 international dealer locations as of July 1, 2016 allows us to distribute our products more broadly and effectively than our competitors. For calendar year 2015, our dealers held or tied for the #1 market share position for the performance sport boat category in 71 of 118 U.S. markets. We have nominal dealer concentration, with no single dealer accounting for more than 5.3% of our unit volume for fiscal year 2016 and 4.7% for fiscal years 2015 and 2014, and our top ten dealers represented 31.9%, 33.7% and 34.1% of our unit volume for fiscal years 2016, 2015 and 2014, respectively. We continually review our geographic coverage to identify opportunities for expansion and improvement, and will, where necessary, add dealer locations to address previously underserved markets or replace under performing dealers.

Highly Recognized Brands. We believe our Malibu and Axis brands are widely recognized in the powerboat industry, which helps us reach a growing number of target consumers. For over 30 years, our Malibu brand has generated a loyal following of recreational boaters and water sports enthusiasts who value the brand’s premium performance and features. Our Axis brand has grown rapidly as consumers have been drawn to its more affordable price point and available optional features. We believe that the appeal of our high performance and innovative products with athletes and enthusiasts contributes to our brand awareness with dealers and with consumers. We are able to build on this brand recognition and support through a series of marketing initiatives coordinated with our dealers or executed directly by us. Many of our marketing efforts are conducted on a grass-roots level domestically and internationally. Key grass-roots initiatives include: production and distribution of water sports videos; online and social marketing; on-the-water events; athlete, tournament and water sport facility sponsorships; and participation and product placement at important industry events. Additionally, our boats, their innovative features, our sponsored athletes and our dealers all frequently win industry awards, which we believe further boosts our brand recognition and reputation for excellence. We believe our marketing strategies and accomplishments enhance our profile in the industry, strengthen our credibility with consumers and dealers and increase the appeal of our brands.

Compelling Margins and Cash Flow. Our net income margin and adjusted EBITDA margin was 8.0% and 19.1%, respectively, for fiscal year 2016. For the definition of adjusted EBITDA margin and a reconciliation to net income (loss), see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations - GAAP Reconciliation of Non-GAAP Financial Measures.” We also produced $35.6 million net cash from operating activities for fiscal year 2016. We have an array of initiatives focused on reducing our cost base and improving the efficiency of our manufacturing process that have enabled us to maintain attractive margins and strong cash flows. We have re-engineered the manufacturing process in our Tennessee facility reducing labor hours per boat produced. We have also improved production throughput and product quality through close collaboration between our product development and manufacturing teams. Further, vertical integration of trailers, towers and tower accessories production gives us the ability to increase incremental margin per boat sold. In addition, our low capital expenditure requirements and a highly efficient working capital cycle have allowed us to generate significant excess cash flow from operations, excluding one-time litigation and settlement costs in fiscal years 2016, 2015 and 2014. We believe our strong cash flow increases our financial stability and provides us with more flexibility to invest in growth initiatives.

Highly Experienced Management Team. Our experienced management team has demonstrated its ability to navigate through various economic cycles, to identify, create and integrate new product innovations, improve financial performance, optimize operations, enhance our distribution model and recruit top industry talent. Our Chief Executive Officer, Jack Springer, joined Malibu Boats in 2009 and has assembled an executive team with strong, complementary talents and experience. This team has led a workforce that we believe has produced superior results, including market share gains, sales growth and profitability improvement.

Our Strategy

We intend to capitalize on the ongoing recovery in the powerboat market through the following strategies:

Continue to Develop New and Innovative Products in Our Core Markets. We intend to continue developing and introducing new and innovative products—both new boat models to better address a broader range of consumers and new features to deliver better performance, functionality, convenience, comfort and safety to our consumers. We believe that new products and features are important to the growth of our market share, the continued expansion of our category and our ability to maintain attractive margins.

Our product development strategy consists of a two-pronged approach. First, we seek to introduce new boat models to target unaddressed or underserved segments of the performance sport boat category, while also updating and refreshing our existing boat models regularly. For example, we introduced Axis-branded boats starting in 2009 to address the entry-level segment of our category, we launched the Malibu Wakesetter MXZ product line in 2012 to enter the premium “picklefork” bow design segment of our market, and in 2016 we released the Malibu M235 designed to deliver luxury and performance in the ultra-premium market. Second, we seek to develop and integrate innovative new features into our boats, such as Surf Gate, Malibu Touch Command and Power Wedge. Over the past two years, we have continued these strategies by introducing eight new models, including three in the Axis line, and we have enhanced our optional feature offerings with the new Power Wedge II and the industry's first 12-inch touchscreen dash system. For the 2016 model year, which began July 1, 2015, we released the Wakesetter 25 LSV, the Wakesetter 20 VTX and the Axis A20 and in November 2015 we launched the Malibu M235. In addition, on our model year 2016 products, we offered an improved Surf Gate system with hydraulic actuators, our patented rider controlled Surf Band technology, new windshields, new vinyl and backup cameras. Furthermore, at the end of fiscal year 2015 we began production of trailers for the model year 2016 product, continuing our vertical integration strategy focused on delivering better quality and value to our consumers while enhancing margins. For the 2017 model year, we released the Wakesetter 22 MXZ, the Wakesetter 24 MXZ and the Wakesetter 21VLX. We intend to continue releasing new products and features multiple times during the year, which we believe enhances our reputation as a leading-edge boat manufacturer and provides us with a competitive advantage.

Capture Additional Share from Adjacent Boating Categories. Our culture of innovation has enabled us to expand the market for our products by attracting consumers from other categories, most notably from the sterndrive category. As illustrated by the chart below, the new unit sales volume of performance sport boats steadily increased from 2001 through 2015 as a percentage of the total new unit sales volume of performance sport boats and sterndrive boats. While there is no guarantee that this trend will continue in the future, we believe our market-leading position and broad offering of boat models and features will continue to attract consumers to our performance sport boats.

We intend to continue to enhance the performance, comfort and versatility of our products in order to further target crossover consumers seeking high-performance powerboats for general recreational activity. For example, we believe that one of our newest boat models, the Wakesetter 25 LSV, appeals to a broader range of recreational boaters by offering the performance benefits of our products, including superior drivability and water sports versatility, while also providing greater seating capacity, a roomy, plush interior and extensive storage space to allow an increased number of family and friends to spend time together on the water. In addition, in fiscal year 2016, we released a new line of boats in the ultra-premium segment anchored by the M235, which is designed to deliver luxury and performance in the ultra-premium market.

Further Strengthen Our Dealer Network. Our goal is to achieve and maintain leading market share in each of the markets in which we operate. We continually assess our distribution network and take the actions necessary to achieve our goal. We intend to strengthen our current footprint by selectively recruiting market-leading dealers who currently sell our competitors’ products. In addition, we plan to continue expanding our dealer network in certain geographic areas to increase consumer access and service in markets where it makes strategic sense. We believe our targeted initiatives to enhance and grow our dealer network will increase unit sales in the future.

Accelerate International Expansion. Based on our U.S. leadership position, brand recognition, diverse, innovative product offering and distribution strengths, we believe that we are well-positioned to increase our international sales. Our 53% market share of performance sport boat exports to international markets for the last twelve months ended March 31, 2016 was the highest among U.S. manufacturers and is supported by an extensive international distribution network of 58 international dealer locations. Including our Australia operations which we acquired in October 2014, unit volumes outside of North America accounted for approximately 8.0% of our total unit volume for fiscal years 2016 and 2015. We believe we will increase our international sales both by promoting our products in developed markets where we have a well-established dealer base, such as Western Europe, and by penetrating new and emerging markets where we expect rising consumer incomes to increase demand for recreational products, such as Asia and South America, although there is no guarantee that our efforts will be successful or that international sales will increase.

Over the last few years we have taken a number of steps to enhance our international presence and our ability to drive sales in developed and emerging markets. In fiscal year 2013, we restructured our agreements with those parties to provide for direct sales coverage of key markets, including Central America, South America, Asia (excluding the Middle East) and most of Africa. In fiscal year 2015, we acquired our exclusive licensee in Australia. In fiscal year 2016, to better manage and optimize international sales in Europe, we have added dedicated company resources and increased our sales and marketing activity there, including international dealer meetings, dealer service schools, regional marketing campaigns and promotional visits by water sport athletes. We expect the growing demand for our product to continue, but the continued strength of the U.S. dollar has had an impact on international markets.

Our Products and Brands

We design, manufacture and sell performance sport boats that we believe deliver superior performance for water sports, including wakeboarding, water skiing and wake surfing, as well as general recreational boating. We market our boats under two brands:

- Malibu, our flagship brand, dates to our inception in 1982, primarily targeting consumers seeking a premium boating experience and offering our latest innovations in performance, comfort and convenience; and
- Axis, which we launched as a new brand in 2009, targets a younger demographic and provides them with a more affordably priced, entry-level boat that provides high performance, functional simplicity and the option to upgrade key features.

In addition, we offer various accessories and aftermarket parts.

Boat Models

We believe our boats are renowned for their performance, design, innovative technology, quality and ability to provide consumers a high-quality boating experience at varying price points. We currently offer a number of performance sport boat models across our two brands, which provide consumers with a variety of options across length, hull type, bow type, horsepower and seating capacity in addition to customizable designs and features available for upgrade across our models. The following table provides an overview of our most popular product offerings by brand:

Brand	Series	Number of Models	Lengths	Hull Types	Bow Types	Maximum Power	Maximum Capacity (persons)	Retail Price Range (In thousands)
Malibu	M	1	23.5’	Wake Plus	Picklefork	575 Lb-ft	11-17	$160-$175
Malibu	Wakesetter	7	20’-25’	Wake, Cut Diamond, Diamond	Traditional, Picklefork	575 Lb-ft	11-19	$65-$150
Malibu	Response	3	20’-21’	Cut Diamond	Traditional	450 Lb-ft	5-7	$40-$75
Axis	Axis	5	20’-24’	Wake	Traditional, Picklefork	555 Lb-ft	11-17	$45-$95

- Malibu M Series. The Malibu M235, created in 2015, is a new line of ultra-premium towboats, built from the ground up by a team of our designers, engineers, and athletes, and designed to provide consumers with a seamless blend of beauty, luxury, and power. The M235, at almost 24 feet, is deeper than any other boat in our category and loaded with every technologically innovative feature we offer including our Integrated Surf Platform, premium luxury interiors, and most advanced helm in the industry. Further, the M235 is driven by our most powerful engine delivering what we believe is the best performance of any performance sport boat on the market today.
- Malibu Wakesetter. Introduced in 1998, the Wakesetter series is our premium boat series and the top selling series within the performance sport boat category. The Wakesetter series is designed for consumers seeking the highest-performance water sport and boating experience. Wakesetter offers consumers a highly-customizable boat with our most innovative technologies, premium features, newest graphics, color options and interior finishes. Demonstrating Wakesetter’s industry-leading performance and market position, the Wakesetter 23 LSV model was the best-selling boat in the performance sport boat category for fiscal years 2009 through 2015.
- Malibu Response. The Response series, created in 1995, was designed for consumers who desire a high-performance water ski boat. Primarily because of its direct drive engine setup, the Response series produces the smallest wake of any of our boats and is designed to accommodate both professional and recreational skiers by allowing for a range of speeds and line lengths. Demonstrating Response’s reputation for high-performance and quality, the Response TXI model is the boat of choice for Regina Jaquess, a member of the Malibu Pro Ski Team since 2011 and the holder of

the women’s slalom world record.

- Axis. After the continued success with our Wakesetter series, we identified a market opportunity in entry-level performance sport boats and, in 2009, launched our Axis brand. We designed Axis for consumers who desire a lower price point, but who still demand high performance, functional simplicity and the option to upgrade their boats to have key features such as Surf Gate. The Axis series currently has five available models and we plan to refine these models continually as well as add new ones as we build out the brand. We believe the Axis series successfully provides consumers with a high quality water sport and boating experience at an attractive price, as evidenced by its #4 market position in the performance sport boat category after only seven years on the market.

Innovative Features

In addition to the standard features included on all of our boats, we offer consumers the ability to upgrade our base models by adding certain of our full line of innovative features designed to enhance performance, functionality and the overall boating experience. Our innovative features drive our high average selling prices. Some of these include:

- Surf Gate. Introduced in July 2012 and initially patented in September 2013, Surf Gate is available as an optional feature on all Malibu Wakesetter models and Axis brand boats. Surf Gate has revolutionized the increasingly popular sport of wake surfing. Prior to Surf Gate, boaters needed to empty ballast tanks on one side of the boat and shift passengers around to lean the boat to create a larger, more pronounced surf-quality wake. By employing precisely engineered and electronically controlled panels, Surf Gate alleviates this time-consuming and cumbersome process, allowing boaters to easily surf behind an evenly weighted boat without the need to wait for ballast changes. Recent enhancements to Surf Gate have improved upon the system’s actuators, allowing for easier and faster transfer, as well as the installation of an indicator horn and optional light signaling, which alert riders to wave transfers. For the 2016 model year, we introduced our patented Surf Band technology that allows the rider to control the surf wave, shape, size and side. In 2013, the Watersports Industry Association named Surf Gate as Innovation of the Year.
- Manual Wedge/Power Wedge. Our patented Manual Wedge and Power Wedge allow riders to customize their wakes by simulating up to 1,200 pounds of ballast weight in the transom of their boats. Used in conjunction with Surf Gate, wake surfers are able to customize the size and shape of the wave. The Manual Wedge is available on all Malibu and Axis brand boats. Unlike our Manual Wedge, the Power Wedge, available exclusively on our Malibu line, is fully automated and integrated within the Malibu Touch Command system, increasing functionality and ease-of-use for the driver. Re-engineered for model year 2015, we released the Power Wedge II. It features a larger foil and a 21% surface-area increase, which equates to an additional 300 pounds of simulated ballast, for a total of 1,500 pounds of wake-creating water displacement. In addition, a new upward angle increases lift, allowing the driver to achieve a fully loaded boat planing much faster.
- G3/G4 Tower. Our G3 Towers, available on Malibu brand boats, are fully customizable with speakers, power lights and racks, enhancing the overall style, performance and functionality of our boats. Our G3 Tower can easily be folded down by one person with its weightless, gas spring-assisted design, making the G3 Tower safe and easy to store. We are the only manufacturer of performance sport boats that produces towers in-house, allowing us to control this critical design element of our boats. For model year 2015, we offered a new G4 Tower featuring aerospace aluminum and an internal honeycomb structure to provide the optimal strength-to-weight ratio, making the G4 three times more rigid than its predecessor. The new design contains automatic visible locks, a fully integrated wiring harness, Z5 Bimini compatibility, and zero pinch points. The new G4 has an aggressive design yet preserves ease of use by taking less than 30 pounds of force to lift, lower, and latch.
- Electronic Dashboard Controls. Every boat in our Wakesetter series is equipped with our MaliView and Malibu Touch Command ("MTC") systems, which function as an electronic command center that enhances the driver’s experience by providing simple and quick control of all systems on board, including the Power Wedge and Surf Gate systems, rider presets, music, lighting and navigation. For the model year 2015, we were first to market with a 12-inch touchscreen. It joined our seven-inch MTC to form the display for our new Command Center, giving the driver endless data in an easy-to-navigate interface. Every major feature is on the home screen, menu paths have been streamlined and each component meets IP60 water-intrusion standards. Built with more processing power, higher levels of integration, a feature-packed new operating system and powerful wireless connectivity, the new Command Center represents the most advanced screen technology available on performance sport boats.
- Surf Band. Malibu’s exclusive, patented Surf Band allows a rider to strap a buoyant, hi-viz wristband and tap a simple, intuitive remote interface to take command of all aspects of the rider's surfing experience. At the same time, the

interface enables the driver to monitor the rider through alerts on the electronic command center, eliminating the need for hand-signals to the spotters or driver. If the rider is wakeboarding, the Surf Band lets the rider adjust the Power Wedge II and control speed.

We also offer an array of less technological, but nonetheless value-added boat features such as gelcoat upgrades, upholstery upgrades, engine drivetrain enhancements (such as silent exhaust tips, propeller upgrades and closed cooling engine configuration), sound system upgrades, Bimini tops, boat covers and trailers which further increase the level of customization afforded to consumers.

Our Dealer Network

We rely on independent dealers to sell our products. We establish performance criteria that our dealers must meet as part of their dealer agreements to ensure our dealer network remains the strongest in the industry. As a member of our network, dealers in North America may qualify for floor plan financing programs, rebates, seasonal discounts, promotional co-op payments and other allowances. We believe our dealer network is the most extensive in the performance sport boat category. The majority of our dealers, including nine in our top ten markets, are exclusive to Malibu and Axis brand boats within the performance sport boat category, highlighting the commitment of our key dealers to our boats.

North America

In North America, we had a total of 147 dealer locations as of July 1, 2016. Of these locations, 19% sell our products exclusively, 63% are multi-line locations that only carry non-competitive brands and products and 18% sell our brands as well as other performance sport boat brands. Approximately 37% of our dealer locations have been with us for over ten years. For calendar year 2015, our dealers held or tied for the #1 market share position for the performance sport boat category in 71 of 118 U.S. markets.

We consistently review our distribution network to identify opportunities to expand our geographic footprint and improve our coverage of the market. We have the ability to opportunistically add new dealers and new dealer locations to previously underserved markets and use data and performance metrics to monitor dealer performance. We believe our outstanding dealer network allows us to distribute our products more efficiently than our competitors.

We do not have a significant concentration of sales among our dealers. For fiscal year 2016, our top ten dealers accounted for 31.9% of our units sold and none of our dealers accounted for more than 5.3% of our total sales volume.

We believe that our strong market position in each region of the United States will help us capitalize on growth opportunities as our industry continues to recover from the economic downturn. In particular, we expect to generate continued growth in the southwestern United States (which includes California), a region that experienced the most pronounced decline in sales of new performance sport boats and where we have our highest regional market share.

The following graph provides a comparison of the number of units sold by U.S. geographic region during fiscal year 2006, when the market was generally at its pre-recession peak, and calendar year 2015, as well as our U.S. market share in the performance sport boat category for calendar year 2015:

Market Size and Our Market Share by Region
2015 Market Share 35% 32% 30% 29% 32% 41%
International
As of July 1, 2016, our extensive international distribution network consisted of 58 international dealer locations in 33 countries, including Europe, Asia, Middle East, South America, South Africa, and Australia/New Zealand. We service our independent dealers in the Australian and New Zealand markets through our Australian operations acquired in October 2014. Including our Australia operations, international unit volumes accounted for approximately 8.0% of our total unit volume for fiscal years 2016 and 2015.
For our international sales, other than Australia, we have historically relied, in part, on our relationship with an independent representative who serviced international dealer arrangements in Europe, the Middle East and South Africa on our behalf and was responsible for managing dealer relationships, dealer sourcing and account management, which included order management and customer service support in those countries. Under the terms of the agreement with the independent representative, the independent representative purchased boats directly from us at a predetermined percentage discount. These sales were made under the same terms and conditions offered to all dealers, which include, among other things, no right of return except in limited circumstances under our warranty policy. Like sales to our dealers, there were no continuing performance obligations in connection with our sales to the independent representative. Revenue from these sales has been recognized in accordance with our customary shipping terms, free on board shipping point. A fixed percentage discount was earned by the independent representative at the time a boat was shipped as a reduction in the price of the boat and recorded in our consolidated statement of operations and comprehensive income (loss) as a reduction in sales.
To further our international expansion strategy, we ended our relationship with the independent representative during the fourth quarter of fiscal 2016 after several years of transitioning parts of the international market to a direct relationship with Malibu and its international dealers. Effective July, 1, 2016, we assumed direct management of Europe, the Middle East and South Africa from the former international representative. We believe this model will provide additional expansion opportunities which will lead to increased unit sales and more revenue over time.
Dealer Management

Our relationship with our dealers is governed through dealer agreements. Each dealer agreement has a finite term lasting between one and three years. Our dealer agreements also are typically terminable without cause by the dealer at any time and by us with 90 days' prior notice. We may also generally terminate these agreements immediately for cause upon certain events. Pursuant to our dealer agreements, the dealers typically agree to, among other things:

- represent our products at specified boat shows;
- market our products only to retail end users in a specific geographic territory;
- promote and demonstrate our products to consumers;
- place a specified minimum number of orders of our products during the term of the agreement in exchange for rebate eligibility that varies according to the level of volume they commit to purchase;
- provide us with regular updates regarding the number and type of our products in their inventory;
- maintain a service department to service our products, and perform all appropriate warranty service and repairs; and
- indemnify us for certain claims.

Our dealer network, including all additions, renewals, non-renewals or terminations, is managed by our sales personnel. Our sales team operates using a semi-annual dealer review process involving our senior management team. Each individual dealer is reviewed semi-annually with a broad assessment across multiple key elements, including the dealer's geographic region, market share and customer service ratings, to identify underperforming dealers for remediation and to manage the transition process when non-renewal or termination is a necessary step.

We have developed a system of financial incentives for our dealers based on customer satisfaction and achievement of best practices. Our dealer incentive program has been refined through nearly 30 years of experience and provides the following key elements:

- Rebates. Our dealers agree to an annual commitment volume that places each dealer into a certain rebate tier and determines its prospective rebate percentage. If a dealer meets its annual commitment volume as well as other terms of the rebate program, the dealer is entitled to the specified rebate. Failure to meet the commitment volume may result in partial or complete forfeiture of the dealer's rebate.
- Co-op. Dealers of the Malibu product line may earn certain co-op reimbursements upon reaching a specified level of qualifying expenditures.
- Free flooring. Our dealers that take delivery of current model year boats in the offseason, typically July through April, are entitled to have us pay the interest to floor the boat until the earlier of (1) the sale of the unit or (2) a date near the end of the current model year. This program is an additional incentive to encourage dealers to order in the offseason and helps us balance our seasonal production.

Our dealer incentive programs are also structured to promote more evenly distributed ordering throughout the fiscal year, which allows us to achieve better level-loading of our production and thereby generate plant operating efficiencies. In addition, these programs offer further rewards for dealers who are exclusive to Malibu and Axis in our performance sport boat category.

Floor Plan Financing

Our North American dealers often purchase boats through floor plan financing programs with third-party floor plan financing providers. During fiscal year 2016, approximately 87% of our domestic shipments were made pursuant to floor plan financing programs through which our dealers participate. These programs allow dealers to establish lines of credit with third-party lenders to purchase inventory. Under these programs, a dealer draws on the floor plan facility upon the purchase of our boats and the lender pays the invoice price of the boats. As is typical in our industry, we have entered into repurchase agreements with certain floor plan financing providers to our dealers. Under the terms of these arrangements, in the event a lender repossesses a boat from a dealer that has defaulted on its floor financing arrangement and is able to deliver the repossessed boat to us, we are obligated to repurchase the boat from the lender. Our obligation to repurchase such repossessed products for the unpaid balance of our original invoice price for the boat is subject to reduction or limitation based on the age and condition of the boat at the time of repurchase, and in certain cases by an aggregate cap on repurchase obligations associated with a particular floor financing program.

Our exposure under repurchase agreements with third-party lenders is mitigated by our ability to reposition inventory with a new dealer in the event that a repurchase event occurs. The primary cost to us of a repurchase event is any loss on the resale

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of a repurchased unit, which is often less than 10% of the repurchase amount. For fiscal year 2016, we agreed to repurchase three units from the lender of two of our former dealers. Other than these repurchase commitments, the Company has not repurchased any boats under our repurchase agreements since July 1, 2010.

Marketing and Sales

We believe that providing a high level of service to our dealers and end consumers is essential to maintaining our reputation. Our sales personnel receive training on the latest Malibu Boats products and technologies, as well as training on our competitors' products and technologies, and attend trade shows to increase their market knowledge. This training is then passed along to our dealers to ensure a consistent marketing message and leverage our marketing expenditures. We enjoy strong brand awareness, as evidenced by our substantial market share.

Our marketing strategy focuses on strengthening and promoting the Malibu and Axis brands in the performance sport boat marketplace. One element of our marketing strategy involves specialized promotions at competitive water sports events, and individual and team sponsorships. Our leading position in the performance sport boat category is supported by our sponsorship of some of the most prestigious water sports competitions, including the Malibu Evolution Pro Series, Malibu Open and World Wakeboard Association Riders Experience, which we believe positively influences the purchasing habits of enthusiasts and other consumers seeking high-performance products. These events feature the most popular figures in water sports, drawing large audiences of enthusiasts to a variety of sites around the country. Further, these events are focused on fan and retail consumer engagement and offer interactive, experiential opportunities for consumers to experience watersports behind our product. To aid in driving brand awareness we also sponsor a team of elite male and female athletes from the professional water sports tours. Team Malibu includes legendary wakeboarders such Ralph Derome and Amber Wing, along with World Wakeskate Champion and two-time Masters Champion Brian Grubbs. Additionally leading members of the team are World Champion waterskiers Thomas Degasperi and World Record Holder Regina Jaquess. The Axis Wake Research Pro Team includes watersports legends like Brostock Champion, Video of the Year winner, Randall Harris and King of the Cable, Best Wake Park Rider, and Wake Park World Series Champion Tom Fooshee. We believe that the performance of our products has been demonstrated by, and our brands benefit from, the success of professional athletes who use our products.

In addition to our website and traditional marketing channels, such as print advertising and tradeshows, we maintain an active digital advertising and social media platform, including use of Facebook and Twitter to increase brand awareness, foster loyalty and build a community of users. In addition, we benefit from the various Malibu and Axis user-generated videos and photos that are uploaded to websites including YouTube, Vimeo and Instagram. As strategies and marketing plans are developed for our products, our internal marketing and communications group works to ensure brand cohesion and consistency. We believe that our marketing initiatives, as well as our strategic focus on product innovation, performance and quality attracts aspiring and enthusiast consumers to our brands and products.

Product Development and Engineering

We are strategically and financially committed to innovation, as reflected in our dedicated product development and engineering group and evidenced by our track record of new product introduction. Our product development and engineering group spans both our Tennessee headquarters and our California facility and comprises 18 professionals. These individuals bring to our product development efforts significant expertise across core disciplines, including boat design, trailer design, computer-aided design, electrical engineering and mechanical engineering. They are responsible for execution of all facets of our new product strategy, including designing new and refreshed boat models and new features, engineering these designs for manufacturing and integrating new features into our boats. In addition, our Chief Executive Officer and Chief Operating Officer are actively involved in the product development process and integration into manufacturing.

We take a disciplined approach to the management of our product development strategy. We use a formalized phase gate process, overseen by a dedicated project manager, to develop, evaluate and implement new product ideas for both boat models and innovative features. Application of the phase gate process requires management to establish an overall timeline that is sub-divided into milestones, or "gates," for product development. Setting milestones at certain intervals in the product development process ensures that each phase of development occurs in an organized manner and enables management to become aware of and address any issues in timely fashion, which facilitates on-time, on-target release of new products with expected return on investment. Extensive testing and coordination with our manufacturing group are important elements of our product development process, which we believe enable us to minimize the risk associated with the release of new products. Our phase gate process also facilitates our introduction of new boat models and features throughout the year, which we believe provides us with a competitive advantage in the marketplace. Finally, in addition to our process for managing new product introductions in a given fiscal year, we also engage in longer-term product life cycle and product portfolio planning.

Manufacturing

Our manufacturing efforts are led by our Chief Operating Officer, who brings 30 years of experience in the manufacture of performance sport boats. We manufacture our boats at both our Tennessee and Australia facilities, and we manufacture towers, tower accessories and stainless steel and aluminum billet at our California facility. Beginning with model year 2016, we began manufacturing our own trailers at our Tennessee facility.

Our boats are built through a continuous flow manufacturing process that encompasses fabrication, assembly, quality management and testing. Each boat is produced over a seven-day cycle that includes the fabrication of the hull and deck through gelcoat application and fiberglass lamination, grinding and hole cutting, installation of components, rigging, finishing, detailing and on-the-water testing. Trailers are also produced in a continuous flow manufacturing process involving cutting and bending of the main frame from raw top grade carbon steel, painting using our state of the art system and installation of components. We manufacture certain components and subassemblies for our boats, such as upholstery, stainless steel and aluminum billet and towers. We procure other components, such as engines and electronic controls, from third-party vendors and install them on the boat.

We acquired our tower and tower accessory manufacturing capability in 2009 through the acquisition of certain assets of Titan Wake Accessories, which had been one of our suppliers. Tower-related manufacturing occurs in our Merced-based machine shop, where we use multiple computer-controlled machines to cut all of the aluminum parts required for tower assembly. We are the only performance sport boat company that manufacturers towers in-house. We believe that the vertical integration of these components is a distinct competitive advantage that allows us to control key design elements of our boats and generate higher margins.

We are committed to continuous improvement in our operations, and our efforts in this regard have resulted in higher gross margins. Specifically, we have increased labor efficiency, reduced cost of materials and reduced warranty claims. Our production engineers evaluate and seek to optimize the configuration of our production line given our production volumes and model mix. We use disciplined mold maintenance procedures to maintain the usable life of our molds and to reduce surface defects that would require rework. We have instituted scrap material reduction and recovery processes, both internally and with our supplier base, helping to manage our material costs. Finally, we have implemented a quality management system to ensure that proper procedures and control measures are in place to deliver consistent, high-quality product, especially as our production volumes have increased.

We focus on worker safety in our operations. From July 1, 2012 to June 30, 2016, we recorded 2,601,211 consecutive man-hours with only one lost-time accident in our Tennessee facility, an accomplishment that has reduced workers' compensation claims and warranty costs, as our most experienced employees continue to remain on the job.

Suppliers

We purchase a wide variety of raw materials from our supplier base, including resins, fiberglass, hydrocarbon feedstocks and steel, as well as product parts and components, such as engines and electronic controls, through a sales order process.

We belong to Independent Boat Buildings, Inc., or IBBI, a 20-member marine purchasing cooperative and sit on its board of directors. Membership in IBBI is limited to top-tier manufacturers and is not only helpful for procuring materials, but also helps us stay abreast of technological developments and industry best practices. Although we purchase certain supplies, such as fiberglass and resins, through the IBBI cooperative agreement, we maintain informal arrangements with third-party suppliers outside of the IBBI agreement for other raw materials and components, which we believe ensures that our boats are constructed using the best available components and raw materials.

We have not experienced any material shortages in any of our raw materials, product parts or components. Temporary shortages, when they do occur, usually involve manufacturers of these products adjusting model mixes, introducing new product lines or limiting production in response to an industry-wide reduction in boat demand.

The most significant component used in manufacturing our boats, based on cost, are engines. We maintain a strong and long-standing relationship with our primary supplier of engines from whom we purchased approximately 60% of our engines for fiscal year 2016, and we have also developed a relationship with a second supplier from whom we sourced approximately 40% of our engines for fiscal year 2016. As is typical in our industry, our engine suppliers are marinizers of engines that they procure from larger engine block manufacturers, such as General Motors Corporation.

Insurance and Product Warranties

We carry various insurance policies, including policies to cover general products liability, workers' compensation and other casualty and property risks, to protect against certain risks of loss consistent with the exposures associated with the nature and

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scope of our operations. Our policies are generally based on our safety record as well as market trends in the insurance industry and are subject to certain deductibles, limits and policy terms and conditions.

Effective for model year 2016, we began providing a limited warranty for a period up to five years for both Malibu and Axis brand boats. For model years prior to 2016, we provided a limited warranty for a period of up to three years for our Malibu brand boats and two years for our Axis boats. During the warranty period, we reimburse dealers and Malibu Boats authorized service facilities for all or a portion of the cost of repair or replacement performed on the products (mainly composed of parts or accessories provided by us and labor costs incurred by dealers or Malibu Boats authorized service facilities). Some materials, components or parts of the boat that are not covered by our limited product warranties are separately warranted by their manufacturers or suppliers. These other warranties include warranties covering engines and other components.

Intellectual Property

We rely on a combination of patent, trademark and copyright protection, trade secret laws, confidentiality procedures and contractual provisions to protect our rights in our brand, products and proprietary technology. This is an important part of our business and we intend to continue protecting our intellectual property. We currently hold 18 U.S. patents, one Australian patent, one Canadian patent, seven pending U.S. patent applications and three pending Australian patent applications.

We own 32 registered trademarks in various countries around the world. Such trademarks may endure in perpetuity on a country-by-country basis, provided that we comply with all statutory maintenance requirements, including continued use of each trademark in each such country. We currently do not own any registered copyrights.

Competition

The powerboat industry, including the performance sport boat category, is highly competitive for consumers and dealers. Competition affects our ability to succeed in the markets we currently serve and new markets that we may enter in the future. We compete with several large manufacturers that may have greater financial, marketing and other resources than we do. We compete with large manufacturers who are represented by dealers in the markets in which we now operate and into which we plan to expand. We also compete with a wide variety of small, independent manufacturers. Competition in our industry is based primarily on brand name, price and product performance. For more information, see Item 1A. “Risk Factors—Risks Related to Our Business—Our industry is characterized by intense competition, which affects our sales and profits.”

Environmental, Safety and Regulatory Matters

Our operations and products are subject to extensive environmental, health and safety regulation under various federal, commonwealth, state, and local statutes, ordinances, rules and regulations in the United States and Australia where we manufacture our boats, and in other foreign jurisdictions where we sell our products. We believe we are in material compliance with those requirements. However, we cannot be certain that costs and expenses required for us to comply with such requirements in the future, including for any new or modified regulatory requirements, or to address newly discovered environmental conditions, will not have a material adverse effect on our business, financial condition, operating results, or cash flow. The regulatory programs to which we are subject include the following:

Hazardous Materials and Waste

Certain materials used in our manufacturing, including the resins used in production of our boats, are toxic, flammable, corrosive or reactive and are classified as hazardous materials by the national, state and local governments in those jurisdictions where we manufacture our products. The handling, storage, release, treatment and recycling or disposal of these substances and wastes from our operations are regulated in the United States by the United States Environmental Protection Agency (“USEPA”), and state and local environmental agencies. The handling, storage, release, treatment and recycling or disposal of these substances and wastes from our operations are regulated in Australia by the Australian Department of Environment and Energy, the New South Wales EPA and other state and local authorities. Failure by us to properly handle, store, release, treat, recycle or dispose of our hazardous materials and wastes could result in liability for us, including fines, penalties, or obligations to investigate and remediate any contamination originating from our operations or facilities. We are not aware of any contamination at our current or former facilities for which we could be liable under environmental laws or regulations, and we currently are not undertaking any remediation or investigation activities in connection with any contamination. Future spills or accidents or the discovery of currently unknown conditions or non-compliance could, however, could give rise to

investigation and remediation obligations or related liabilities.
Air Quality

In the United States, the federal Clean Air Act ("CAA") and corresponding state and local laws and rules regulate emissions of air pollutants. Because our manufacturing operations involve molding and coating of fiberglass materials, which involves the emission of certain volatile organic compounds, hazardous air pollutants, and particulate matter, we are required to maintain and comply with a CAA operating permit (Title V permit) for our Tennessee and local air permits for our California facilities. Our air permits require us to monitor our emissions and periodically certify that our emissions are within specified limits. To date, we have not had material difficulty complying with those limits.

The USEPA and the California Air Resources Board ("CARB") have adopted regulations stipulating that many marine propulsion engines and watercraft meet certain air emission standards. Some of those standards requires fitting a catalytic converter to the engine. These regulations also require, among other things, that engine manufacturers provide a warranty that their engines meet USEPA and CARB emission standards. The engines used in our products are subject to these regulations. CARB also recently adopted an evaporative emissions regulation that applies to all MY 2018 spark-ignition marine watercraft with permanently installed fuel tanks sold in California. The new regulation requires subject boat manufacturers to use specific CARB-certified components for the fuel systems in their boats, or to certify the boat meets a related performance standard. The USEPA and CARB emissions regulations have increased the cost to manufacture our products.

OSHA

In the United States, the Occupational Safety and Health Administration ("OSHA") standards limit the amount of emissions to which an employee may be exposed without the need for respiratory protection or upgraded plant ventilation. Our facilities are regularly inspected by OSHA and by state and local inspection agencies and departments. We believe that our facilities comply in all material aspects with these regulations. Although capital expenditures related to compliance with environmental laws are expected to increase, we do not currently anticipate any material expenditure will be required to continue to comply with existing OSHA environmental or safety regulations in connection with our existing manufacturing facilities.

At our New South Wales, Australia ("NSW") facility, employee health and safety is regulated by SafeWork NSW, which also has requirements that limit the amount of certain emissions to which an employee may be exposed without the need for respiratory protection or upgraded plant ventilation. In addition, SafeWork NSW provides licensing and registration for potentially dangerous work, investigates workplace incidents, and enforces work health and safety laws in NSW. Our NSW facilities are regularly inspected by SafeWork NSW. We believe that our facilities comply in all material aspects with these requirements.

Boat Design and Manufacturing Standards

Powerboats sold in the United States must be manufactured to meet the standards of certification required by the United States Coast Guard. In addition, boats manufactured for sale in the European Community must be certified to meet the European Community's imported manufactured products standards. These certifications specify standards for the design and construction of powerboats. We believe that all of our boats meet these standards. In addition, safety of recreational boats in the United States is subject to federal regulation under the Boat Safety Act of 1971, which requires boat manufacturers to recall products for replacement of parts or components that have demonstrated defects affecting safety. We have instituted recalls for defective component parts produced by certain of our third-party suppliers. None of the recalls has had a material adverse effect on our Company.

Employees

As of June 30, 2016, we employed 540 people, 426 of whom work at our facilities in Tennessee, 44 of whom work at our California site, 65 of whom work at our Australia facility and five who work remotely. As of June 30, 2016, approximately 18.3% of our employees were salaried and 81.7% were hourly workers. As of June 30, 2015, we had 509 employees. We believe we maintain excellent relations with our employees, treating them as business partners and focusing on building careers. As of June 30, 2016, more than 14.8% of our employees had been with us for ten or more years.

None of our employees are represented by a labor union and, since our founding in 1982, we have never experienced a labor-related work stoppage. Since 2012, we have engaged an outside consultant to assist with employee training, in order to provide our employees a path for upward mobility and develop leadership skills applicable to their day-to-day responsibilities.

Organizational Structure

Malibu Boats, Inc. was incorporated as a Delaware corporation on November 1, 2013 in anticipation of the IPO to serve as a holding company that owns only an interest in Malibu Boats Holdings, LLC. Immediately after the completion of the Recapitalization (as defined below) and IPO, Malibu Boats, Inc. held approximately 49.3% of the economic interest in the LLC,

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which has since increased to approximately 92.6% of the economic interest in the LLC as of June 30, 2016. See Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion of our Recapitalization (as defined therein), IPO, and subsequent equity transactions.

The certificate of incorporation of Malibu Boats, Inc. authorizes two classes of common stock, Class A Common Stock and Class B Common Stock. Holders of our Class A Common Stock and our Class B Common Stock have voting power over Malibu Boats, Inc., the sole managing member of the LLC, at a level that is consistent with their overall equity ownership of our business. In connection with the Recapitalization and IPO, Malibu Boats, Inc. issued to each pre-IPO owner, for nominal consideration, one share of Class B Common Stock of Malibu Boats, Inc., each of which provides its owner with no economic rights but entitles the holder to one vote on matters presented to stockholders of Malibu Boats, Inc. for each LLC Unit held by such holder. Pursuant to our certificate of incorporation and bylaws, each share of Class A Common Stock entitles the holder to one vote with respect to each matter presented to our stockholders on which the holders of Class A Common Stock are entitled to vote. Each holder of Class B Common Stock is entitled to the number of votes equal to the total number of LLC units held by such holder multiplied by the exchange rate specified in the exchange agreement with respect to each matter presented to our stockholders on which the holders of Class B Common Stock are entitled to vote. Accordingly, the holders of LLC Units collectively have a number of votes that is equal to the aggregate number of LLC Units that they hold. As the LLC members sell LLC Units to us or subsequently exchange LLC Units for shares of Class A Common Stock of Malibu Boats, Inc. pursuant to the exchange agreement described below, the voting power afforded to them by their shares of Class B Common Stock is automatically and correspondingly reduced. Subject to any rights that may be applicable to any then outstanding preferred stock, our Class A and Class B Common Stock vote as a single class on all matters presented to our stockholders for their vote or approval, except as otherwise provided in our certificate of incorporation or bylaws or required by applicable law. In addition, subject to preferences that may apply to any shares of preferred stock outstanding at the time, the holders of our Class A Common Stock are entitled to share equally, identically and ratably in any dividends or distributions (including in the event of any voluntary or involuntary liquidation, dissolution or winding up of our affairs) that our board of directors may determine to issue from time to time, while holders of our Class B Common Stock do not have any right to receive dividends or other distributions.

As noted above, Malibu Boats, Inc. is a holding company with a controlling equity interest in the LLC. Malibu Boats, Inc., as sole managing member of the LLC, operates and controls all of the business and affairs and consolidates the financial results of the LLC. The limited liability company agreement of the LLC provides that it may be amended, supplemented, waived or modified by the written consent of Malibu Boats, Inc., as managing member of the LLC, in its sole discretion without the approval of any other holder of LLC Units, except that no amendment may materially and adversely affect the rights of a holder of LLC Units, other than on a pro rata basis with other holders of LLC Units, without the consent of such holder (unless more than one holder is so affected, then the consent of a majority of such affected holders is required). Pursuant to the limited liability company agreement of the LLC, Malibu Boats, Inc. has the right to determine when distributions (other than tax distributions) will be made to the members of the LLC and the amount of any such distributions. If Malibu Boats, Inc. authorizes a distribution, such distribution will be made to the members of the LLC (including Malibu Boats, Inc.) pro rata in accordance with the percentages of their respective LLC Units.

The diagram below depicts our current organizational structure, as of June 30, 2016:

Our organizational structure allows the LLC members to retain their equity ownership in the LLC, an entity that is classified as a partnership for U.S. federal income tax purposes, in the form of LLC Units. Holders of Class A Common Stock, by contrast, hold their equity ownership in Malibu Boats, Inc., a Delaware corporation that is a domestic corporation for U.S. federal income tax purposes, in the form of shares of Class A Common Stock. We believe that the LLC members generally will find it advantageous to hold their equity interests in an entity that is not taxable as a corporation for U.S. federal income tax purposes. The holders of LLC Units, including Malibu Boats, Inc., will incur U.S. federal, state and local income taxes on their proportionate share of any taxable income of the LLC. Net profits and net losses of the LLC will generally be allocated to the LLC's members (including Malibu Boats, Inc.) pro rata in accordance with the percentages of their respective limited liability company interests. The limited liability company agreement provides for cash distributions to the holders of LLC Units if Malibu Boats, Inc. determines that the taxable income of the LLC will give rise to taxable income for its members. In accordance with the limited liability company agreement, we intend to cause the LLC to make cash distributions to the holders of LLC Units for purposes of funding their tax obligations in respect of the income of the LLC that is allocated to them. Generally, these tax distributions will be computed based on our estimate of the taxable income of the LLC allocable to such holder of LLC Units multiplied by an assumed tax rate equal to the highest effective marginal combined U.S. federal, state and local income tax rate prescribed for an individual or corporate resident in Los Angeles, California (taking into account the nondeductibility of certain expenses and the character of our income). For purposes of determining the taxable income of the LLC, such determination will be made by generally disregarding any adjustment to the taxable income of any member of the LLC that arises under the tax basis adjustment rules of the Internal Revenue Code of 1986, as amended, or the Code and is attributable to the acquisition by such member of an interest in the LLC in a sale or exchange transaction.

Exchanges and Other Transactions with Holders of LLC Units

In connection with the Recapitalization and IPO, we entered into an exchange agreement with the pre-IPO owners of the LLC under which (subject to the terms of the exchange agreement) each pre-IPO owner (or its permitted transferee) has the right to exchange its LLC Units for shares of our Class A Common Stock on a one-for-one basis, subject to customary conversion rate adjustments for stock splits, stock dividends and reclassifications, or, at our option, except in the event of a change in control, for a cash payment equal to the market value of the Class A Common Stock. The exchange agreement provides, however, that such exchanges must be for a minimum of the lesser of 1,000 LLC Units, all of the LLC Units held by the holder, or such amount as we determine to be acceptable. The exchange agreement also provides that an LLC member will not have the right to exchange LLC Units if Malibu Boats, Inc. determines that such exchange would be prohibited by law or regulation or would violate other agreements with Malibu Boats, Inc. to which the LLC member may be subject or any of our written policies related to unlawful or insider trading. The exchange agreement also provides that Malibu Boats, Inc. may impose additional restrictions on exchanges that it determines to be necessary or advisable so that the LLC is not treated as a "publicly traded partnership" for U.S. federal income tax purposes. In addition, pursuant to the limited liability company agreement of the LLC, Malibu Boats, Inc., as managing member of the LLC, has the right to require all members of the LLC to exchange their LLC Units for Class A Common Stock in accordance with the terms of the exchange agreement, subject to the consent of the holders of a majority of outstanding LLC Units other than those held by Malibu Boats, Inc.

As a result of exchanges of LLC Units into Class A Common Stock and purchases by Malibu Boats, Inc. of LLC Units from holders of LLC Units, like we completed in our IPO and follow-on offerings, Malibu Boats, Inc. will become entitled to a proportionate share of the existing tax basis of the assets of the LLC at the time of such exchanges or purchases. In addition, such exchanges and purchases of LLC Units are expected to result in increases in the tax basis of the assets of the LLC that otherwise would not have been available. These increases in tax basis may reduce the amount of tax that Malibu Boats, Inc. would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets. We have entered into a tax receivable agreement with the pre-IPO owners (or their permitted assignees) that provides for the payment by Malibu Boats, Inc. to the pre-IPO owners (or their permitted assignees) of 85% of the amount of the benefits, if any, that Malibu Boats, Inc. is deemed to realize as a result of (1) increases in tax basis and (2) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. These payment obligations are obligations of Malibu Boats, Inc. and not of the LLC.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act are available on our web site at www.malibuboats.com, free of charge, as soon as reasonably practicable after the electronic filing of these reports with, or furnishing of these reports to, the Securities and Exchange Commission, or the SEC. Any materials we file with the SEC are available at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Additional information about the operation of the Public Reference Room can also be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains a web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us.

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Item 1A. Risk Factors
The following describes the risks and uncertainties that could cause our actual results to differ materially from those presented in our forward-looking statements. The risks and uncertainties described below are not the only ones we face but do represent those risks and uncertainties that we believe are material to us. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also harm our business.
Risks Related to Our Business
General economic conditions, particularly in the United States, affect our industry, demand for our products, and our business and results of operations.
General economic conditions continue to be challenging as the economy recovers from the effects of the financial crisis that led to the last recession in the United States. Demand for new performance sport boats has been significantly influenced by weak economic conditions, low consumer confidence and high unemployment and increased market volatility worldwide, especially in the United States. In times of economic uncertainty and contraction, consumers tend to have less discretionary income and to defer or avoid expenditures for discretionary items, such as our products. Sales of our products are highly sensitive to personal discretionary spending levels, and our success depends on general economic conditions and overall consumer confidence and personal income levels. Any deterioration in general economic conditions that diminishes consumer confidence or discretionary income may reduce our sales and adversely affect our business, financial condition and results of operations. We cannot predict the duration or strength of an economic recovery, either in the United States or in the specific markets where we sell our products.
Consumers often finance purchases of our products. Although consumer credit markets have improved, consumer credit market conditions continue to influence demand, especially for boats, and may continue to do so. There continue to be fewer lenders, tighter underwriting and loan approval criteria and greater down payment requirements than in the past. If credit conditions worsen, and adversely affect the ability of consumers to finance potential purchases at acceptable terms and interest rates, it could result in a decrease in the sales of our products.
Our annual and quarterly financial results are subject to significant fluctuations depending on various factors, many of which are beyond our control.
Our sales and operating results can vary significantly from quarter to quarter and year to year depending on various factors, many of which are beyond our control. These factors include, but are not limited to:

- seasonal consumer demand for our products;
- discretionary spending habits;
- changes in pricing in, or the availability of supply in, the used powerboat market;
- variations in the timing and volume of our sales;
- the timing of our expenditures in anticipation of future sales;
- sales promotions by us and our competitors;
- changes in competitive and economic conditions generally;
- consumer preferences and competition for consumers’ leisure time; and
- changes in the cost or availability of our labor.

As a result, our results of operations may decline quickly and significantly in response to changes in order patterns or rapid decreases in demand for our products. We anticipate that fluctuations in operating results will continue in the future.

In addition to the factors noted above, unfavorable weather conditions may have a material adverse effect on our business, financial condition, and results of operations, especially during the peak boating season.

Adverse weather conditions in any year in any particular geographic region may adversely affect sales in that region, especially during the peak boating season. Sales of our products are generally stronger just before and during spring and summer, which represent the peak boating months in most of our markets, and favorable weather during these months generally has a positive effect on consumer demand. Conversely, unseasonably cool weather, excessive rainfall, reduced rainfall levels, or

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drought conditions during these periods may close area boating locations or render boating dangerous or inconvenient, thereby generally reducing consumer demand for our products. Our annual results would be materially and adversely affected if our net sales were to fall below expected seasonal levels during these periods. We may also experience more pronounced seasonal fluctuation in net sales in the future as we continue to expand our businesses. Additionally, to the extent that unfavorable weather conditions are exacerbated by global climate change or otherwise, our sales may be affected to a greater degree than we have previously experienced. There can be no assurance that weather conditions will not have a material effect on the sales of any of our products.

We depend on our network of independent dealers, face increasing competition for dealers and have little control over their activities.

Substantially all of our sales are derived from our network of independent dealers. We have agreements with the dealers in our network that typically provide for one-year terms, although some agreements have a term of up to three years. For fiscal years 2016, 2015 and 2014, our top ten dealers accounted for 31.9%, 33.7% and 34.1%, respectively, of our total units sold. The loss of a significant number of these dealers could have a material adverse effect on our financial condition and results of operations. The number of dealers supporting our products and the quality of their marketing and servicing efforts are essential to our ability to generate sales. Competition for dealers among performance sport boat manufacturers continues to increase based on the quality, price, value and availability of the manufacturer’s products, the manufacturer’s attention to customer service and the marketing support that the manufacturer provides to the dealers. We face intense competition from other performance sport boat manufacturers in attracting and retaining dealers, and we cannot assure you that we will be able to attract or retain relationships with qualified and successful dealers. We cannot assure you that we will be able to maintain or improve our relationship with our dealers or our market share position. In addition, independent dealers in the powerboat industry have experienced significant consolidation in recent years, which could result in the loss of one or more of our dealers in the future if the surviving entity in any such consolidation purchases similar products from a competitor. A substantial deterioration in the number of dealers or quality of our network of dealers would have a material adverse effect on our business, financial condition and results of operations.

Our success depends, in part, upon the financial health of our dealers and their continued access to financing.

Because we sell nearly all of our products through dealers, their financial health is critical to our success. Our business, financial condition and results of operations may be adversely affected if the financial health of the dealers that sell our products suffers. Their financial health may suffer for a variety of reasons, including a downturn in general economic conditions, rising interest rates, higher rents, increased labor costs and taxes, compliance with regulations and personal financial issues.

In addition, our dealers require adequate liquidity to finance their operations, including purchases of our products. Dealers are subject to numerous risks and uncertainties that could unfavorably affect their liquidity positions, including, among other things, continued access to adequate financing sources on a timely basis on reasonable terms. These sources of financing are vital to our ability to sell products through our distribution network. Access to floor plan financing generally facilitates our dealers’ ability to purchase boats from us, and their financed purchases reduce our working capital requirements. If floor plan financing were not available to our dealers, our sales and our working capital levels would be adversely affected. The availability and terms of financing offered by our dealers’ floor plan financing providers will continue to be influenced by:

- their ability to access certain capital markets and to fund their operations in a cost-effective manner;
- the performance of their overall credit portfolios;
- their willingness to accept the risks associated with lending to dealers; and
- the overall creditworthiness of those dealers.

We may be required to repurchase inventory of certain dealers.

Many of our dealers have floor plan financing arrangements with third-party finance companies that enable the dealers to purchase our products. In connection with these agreements, we may have an obligation to repurchase our products from a finance company under certain circumstances, and we may not have any control over the timing or amount of any repurchase obligation nor have access to capital on terms acceptable to us to satisfy any repurchase obligation. This obligation is triggered if a dealer defaults on its debt obligations to a finance company, the finance company repossesses the boat and the boat is returned to us. Our obligation to repurchase a repossessed boat for the unpaid balance of our original invoice price for the boat is subject to reduction or limitation based on the age and condition of the boat at the time of repurchase, and in certain cases by an aggregate cap on repurchase obligations associated with a particular floor financing program. There is no assurance that a dealer will not default on the terms of a credit line in the future. In addition, applicable laws regulating dealer relations may also require us to repurchase our products from our dealers under certain circumstances, and we may not have any control over the timing or amount of any repurchase obligation nor have access to capital on terms acceptable to us to satisfy any repurchase obligation. If we were obligated to repurchase a significant number of units under any repurchase agreement or under applicable dealer laws, our business, operating results and financial condition could be adversely affected.

If we fail to manage our manufacturing levels while still addressing the seasonal retail pattern for our products, our business and margins may suffer.

The seasonality of retail demand for our products, together with our goal of balancing production throughout the year, requires us to manage our manufacturing and allocate our products to our dealer network to address anticipated retail demand. Our dealers must manage seasonal changes in consumer demand and inventory. If our dealers reduce their inventories in response to weakness in retail demand, we could be required to reduce our production, resulting in lower rates of absorption of fixed costs in our manufacturing and, therefore, lower margins. As a result, we must balance the economies of level production with the seasonal retail sales pattern experienced by our dealers. Failure to adjust manufacturing levels adequately may have a material adverse effect on our financial condition and results of operations.

We have a large fixed cost base that will affect our profitability if our sales decrease.

The fixed cost levels of operating a powerboat manufacturer can put pressure on profit margins when sales and production decline. Our profitability depends, in part, on our ability to spread fixed costs over a sufficiently large number of products sold and shipped, and if we make a decision to reduce our rate of production, gross or net margins could be negatively affected. Consequently, decreased demand or the need to reduce production can lower our ability to absorb fixed costs and materially impact our financial condition or results of operations.

Our industry is characterized by intense competition, which affects our sales and profits.

The performance sport boat category, and the powerboat industry as a whole, is highly competitive for consumers and dealers. We also compete against consumer demand for used boats. Competition affects our ability to succeed in both the markets we currently serve and new markets that we may enter in the future. Competition is based primarily on brand name, price, product selection and product performance. We compete with several large manufacturers that may have greater financial, marketing and other resources than we do and who are represented by dealers in the markets in which we now operate and into which we plan to expand. We also compete with a variety of small, independent manufacturers. We cannot assure you that we will not face greater competition from existing large or small manufacturers or that we will be able to compete successfully with new competitors. Our failure to compete effectively with our current and future competitors would adversely affect our business, financial condition and results of operations.

Our sales may be adversely impacted by increased consumer preference for used boats or the supply of new boats by competitors in excess of demand.

During the economic downturn, we observed a shift in consumer demand toward purchasing more used boats, primarily because prices for used boats are typically lower than retail prices for new boats. If this were to continue or occur again, it could have the effect of reducing demand among retail purchasers for our new boats. Also, while we have taken steps designed to balance production volumes for our boats with demand, our competitors could choose to reduce the price of their products, which could have the effect of reducing demand for our new boats. Reduced demand for new boats could lead to reduced sales by us, which could adversely affect our business, results of operations or financial condition.

Our sales and profitability depend, in part, on the successful introduction of new products.

Market acceptance of our products depends on our technological innovation and our ability to implement technology in our boats. Our sales and profitability may be adversely affected by difficulties or delays in product development, such as an inability to develop viable or innovative new products. Our failure to introduce new technologies and product offerings that our markets desire could adversely affect our business, financial condition and results of operations. Also, we have been able to achieve higher margins in part as a result of the introduction of new features or enhancements to our existing boat models. If we fail to introduce new features or those we introduce fail to gain

market acceptance, our margins may suffer.
In addition, some of our direct competitors and indirect competitors may have significantly more resources to develop and patent new technologies. It is possible that our competitors will develop and patent equivalent or superior technologies and other products that compete with ours. They may assert these patents against us and we may be required to license these patents on unfavorable terms or cease using the technology covered by these patents, either of which would harm our competitive position and may materially adversely affect our business.

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We also cannot be certain that our products or technologies have not infringed or will not infringe the proprietary rights of others. Any such infringement could cause third parties, including our competitors, to bring claims against us, resulting in significant costs and potential damages.

We compete with a variety of other activities for consumers' scarce leisure time.

Our boats are used for recreational and sport purposes, and demand for our boats may be adversely affected by competition from other activities that occupy consumers' leisure time and by changes in consumer life style, usage pattern or taste. Similarly, an overall decrease in consumer leisure time may reduce consumers' willingness to purchase and enjoy our products.

Our success depends upon the continued strength of our brands, Malibu and Axis, and the value of our brands and sales of our products could be diminished if we, the athletes who use our products or the sports and activities in which our products are used, are associated with negative publicity.

We believe that our brands, Malibu and Axis, are significant contributors to the success of our business and that maintaining and enhancing our brands are important to expanding our consumer and dealer base. Failure to continue to protect our brands may adversely affect our business, financial condition and results of operations.

Negative publicity, including that resulting from severe injuries or death occurring in the sports and activities in which our products are used, could negatively affect our reputation and result in restrictions, recalls or bans on the use of our products. Further, actions taken by athletes associated with our products that harm the reputations of those athletes could also harm our brand image and adversely affect our financial condition. If the popularity of the sports and activities for which we design, manufacture and sell products were to decrease as a result of these risks or any negative publicity, sales of our products could decrease, which could have an adverse effect on our net revenue, profitability and operating results. In addition, if we become exposed to additional claims and litigation relating to the use of our products, our reputation may be adversely affected by such claims, whether or not successful, including by generating potential negative publicity about our products, which could adversely impact our business and financial condition.

We may not be able to execute our manufacturing strategy successfully, which could cause the profitability of our products to suffer.

Our manufacturing strategy is designed to improve product quality and increase productivity, while reducing costs and increasing flexibility to respond to ongoing changes in the marketplace. To implement this strategy, we must be successful in our continuous improvement efforts, which depend on the involvement of management, production employees and suppliers. In addition, we recently began manufacturing our own trailers for model year 2016. Because the integration of our trailer manufacturing is relatively new to us, we must continue to seek ways to improve our trailer production. Any inability to achieve these objectives could adversely impact the profitability of our products and our ability to deliver desirable products to our consumers.

Our ability to meet our manufacturing workforce needs is crucial to our results of operations and future sales and profitability.

We rely on the existence of an available hourly workforce to manufacture our boats. We cannot assure you that we will be able to attract and retain qualified employees to meet current or future manufacturing needs at a reasonable cost, or at all. Although none of our employees is currently covered by collective bargaining agreements, we cannot assure you that our employees will not elect to be represented by labor unions in the future. Additionally, competition for qualified employees could require us to pay higher wages to attract a sufficient number of employees. Significant increases in manufacturing workforce costs could materially adversely affect our business, financial condition or results of operations.

We rely on third-party suppliers and may be unable to obtain adequate raw materials and components.

We depend on third-party suppliers to provide components and raw materials essential to the construction of our boats. Historically, we have not entered into long-term agreements with our suppliers, but have developed 90-day forecast models with our major suppliers to minimize disruptions in our supply chain. While we believe that our relationships with our current suppliers are sufficient to provide the materials necessary to meet present production demand, we cannot assure you that these relationships will continue or that the quantity or quality of materials available from these suppliers will be sufficient to meet our future needs, irrespective of whether we successfully implement our growth strategy. In particular, the availability and cost of engines used in the manufacture of our boats are critical. For fiscal years 2016, 2015 and 2014 we purchased approximately 60%, 62% and 90%, respectively, of the engines for our boats from a single supplier. If we are required to replace this supplier or the supplier of any other key components or raw materials, it could cause a decrease in products available for sale or an

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increase in the cost of goods sold, either of which could adversely affect our business, financial condition and results of operations.

Termination or interruption of informal supply arrangements could have a material adverse effect on our business or results of operations.

We have informal supply arrangements with many of our suppliers. In the event of a termination of the supply arrangement, there can be no assurance that alternate supply arrangements will be made on satisfactory terms. If we need to enter into supply arrangements on unsatisfactory terms, or if there are any delays to our supply arrangements, it could adversely affect our business and operating results.

Product liability, warranty, personal injury, property damage and recall claims may materially affect our financial condition and damage our reputation.

We are engaged in a business that exposes us to claims for product liability and warranty claims in the event our products actually or allegedly fail to perform as expected or the use of our products results, or is alleged to result, in property damage, personal injury or death. In the past, we have provided limited product warranties, generally covering periods from 12 to 36 months for Malibu brand boats and 12 to 24 months for Axis brand boats. Effective July 1, 2015, we began providing a limited warranty for a period up to five years to our consumers for both our Malibu and Axis brand boats manufactured after this point in time. We expect the extension of our warranty coverage period to increase our obligations to cover warranty claims over time resulting in an increase in our reserve to cover these warranty claims.

Our standard warranties require us or our dealers to repair or replace defective products during such warranty periods at no cost to the consumer. Although we maintain product and general liability insurance of the types and in the amounts that we believe are customary for the industry, we are not fully insured against all such potential claims. We may experience legal claims in excess of our insurance coverage or claims that are not covered by insurance, either of which could adversely affect our business, financial condition and results of operations. Adverse determination of material product liability and warranty claims made against us could have a material adverse effect on our financial condition and harm our reputation. In addition, if any of our products are, or are alleged to be, defective, we may be required to participate in a recall of that product if the defect or alleged defect relates to safety. These and other claims we face could be costly to us and require substantial management attention.

We depend upon key personnel and we may not be able to retain them or to attract, assimilate and retain highly qualified employees in the future.

Our future success will depend in significant part upon the continued service of our senior management team and our continuing ability to attract, assimilate and retain highly qualified and skilled managerial, product development, manufacturing, marketing and other personnel. The loss of the services of any members of our senior management or other key personnel or the inability to hire or retained qualified personnel in the future could adversely affect our business, financial condition and results of operations.

We may attempt to grow our business through acquisitions or strategic alliances and new partnerships, which we may not be successful in completing or integrating.

We may in the future explore acquisitions and strategic alliances, similar to our acquisition of our Australian licensee in fiscal year 2015, that will enable us to acquire complementary skills and capabilities, offer new products, expand our consumer base, enter new product categories or geographic markets and obtain other competitive advantages. We cannot assure you, however, that we will identify acquisition candidates or strategic partners that are suitable to our business, obtain financing on satisfactory terms, complete acquisitions or strategic alliances or successfully integrate acquired operations into our existing operations. Once integrated, acquired operations may not achieve anticipated levels of sales or profitability, or otherwise perform as expected. Acquisitions also involve special risks, including risks associated with unanticipated challenges, liabilities and contingencies, and diversion of management attention and resources from our existing operations.

Our growth strategy may require us to secure significant additional capital, the amount of which will depend upon the size, timing, and structure of future acquisitions or vertical integrations and our working capital and general corporate needs.

Our growth strategy could include acquiring businesses, like our acquisition of our Australian licensee in fiscal year 2015, and the integration of new product lines or related products to our boats, such as the integration of the manufacturing of our own trailers beginning with model year 2016. These actions may require us to secure significant additional capital through the borrowing of money or the issuance of equity.

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Any borrowings made to finance future strategic initiatives could make us more vulnerable to a downturn in our operating results, a downturn in economic conditions, or increases in interest rates on borrowings that are subject to interest rate fluctuations. If our cash flow from operations is insufficient to meet our debt service requirements, we could then be required to sell additional equity securities, refinance our obligations or dispose of assets in order to meet our debt service requirements. Adequate financing may not be available if and when we need it or may not be available on terms acceptable to us. The failure to obtain sufficient financing on favorable terms and conditions could have a material adverse effect on our growth prospects.

Further, we could choose to finance acquisitions or other strategic initiatives, in whole or in part through the issuance of our Class A Common Stock or securities convertible into or exercisable for our Class A Common Stock. If we do so, existing stockholders will experience dilution in the voting power of their Class A Common Stock and earnings per share could be negatively impacted. The extent to which we will be able and willing to use our Class A Common Stock for acquisitions and other strategic initiatives will depend on the market value of our Class A Common Stock and the willingness of potential third parties to accept our Class A Common Stock as full or partial consideration. Our inability to use our Class A Common Stock as consideration, to generate cash from operations, or to obtain additional funding through debt or equity financings in order to pursue our strategic initiatives could materially limit our growth.

Our reliance upon patents, trademark laws and contractual provisions to protect our proprietary rights may not be sufficient to protect our intellectual property from others who may sell similar products and may lead to costly litigation. We are currently, and may be in the future, party to lawsuits and other intellectual property rights claims that are expensive and time-consuming.

We hold patents and trademarks relating to various aspects of our products and believe that proprietary technical know-how is important to our business. Proprietary rights relating to our products are protected from unauthorized use by third parties only to the extent that they are covered by valid and enforceable patents or trademarks or are maintained in confidence as trade secrets. We cannot be certain that we will be issued any patents from any pending or future patent applications owned by or licensed to us or that the claims allowed under any issued patents will be sufficiently broad to protect our technology. In the absence of enforceable patent or trademark protection, we may be vulnerable to competitors who attempt to copy our products, gain access to our trade secrets and know-how or diminish our brand through unauthorized use of our trademarks, all of which could adversely affect our business. Accordingly, we may need to engage in future litigation to enforce intellectual property rights to protect trade secrets or to determine the validity and scope of proprietary rights of others. For example, we are currently a plaintiff in two Tennessee lawsuits alleging infringement by a competitor of our patent rights in certain wake surfing technology. For more information, see Note 16 to our audited consolidated financial statements included elsewhere in this Annual Report.

We also rely on unpatented proprietary technology. It is possible that others will independently develop the same or similar technology or otherwise obtain access to our unpatented technology. To protect our trade secrets and other proprietary information, we require employees, consultants, advisors and collaborators to enter into confidentiality agreements. We cannot assure you that these agreements will provide meaningful protection for our trade secrets, know-how, or other proprietary information in the event of any unauthorized use, misappropriation, or disclosure of such trade secrets, know-how, or other proprietary information. If we are unable to maintain the proprietary nature of our technologies, we could be materially adversely affected.

In addition, others may initiate litigation or other proceedings to challenge the validity of our patents, or allege that we infringe their patents, or they may use their resources to design comparable products that do not infringe our patents. We may incur substantial costs if our competitors initiate litigation to challenge the validity of our patents, or allege that we infringe their patents, or if we initiate any proceedings to protect our proprietary rights. As an example, we entered into a settlement agreement in September 2014 and agreed to pay $20.0 million in cash for settlement of a lawsuit alleging patent infringement and related claims against us in connection with windshields installed in our boats that we purchased from a third party supplier. If the outcome of any litigation challenging our patents is unfavorable to us, our business, financial condition and results of operations could be adversely affected.

We rely on network and information systems and other technologies for our business activities and certain events, such as computer hackings, viruses or other destructive or disruptive software or activities may disrupt our operations,

which could have a material adverse effect on our business, financial condition and results of operations.
Network and information systems and other technologies are important to our business activities and operations. Network and information systems-related events, such as computer hackings, cyber threats, security breaches, viruses, or other destructive or disruptive software, process breakdowns or malicious or other activities could result in a disruption of our services and operations or improper disclosure of personal data or confidential information, which could damage our reputation and require us to expend resources to remedy any such breaches. Moreover, the amount and scope of insurance we maintain

against losses resulting from any such events or security breaches may not be sufficient to cover our losses or otherwise adequately compensate us for any disruptions to our businesses that may result, and the occurrence of any such events or security breaches could have a material adverse effect on our business and results of operations. The risk of these systems-related events and security breaches occurring has intensified, in part because we maintain certain information necessary to conduct our businesses in digital form stored on cloud servers. While we develop and maintain systems seeking to prevent systems-related events and security breaches from occurring, the development and maintenance of these systems is costly and requires ongoing monitoring and updating as technologies change and efforts to overcome security measures become more sophisticated. Despite these efforts, there can be no assurance that disruptions and security breaches will not occur in the future. Moreover, we may provide certain confidential, proprietary and personal information to third parties in connection with our businesses, and while we obtain assurances that these third parties will protect this information, there is a risk that this information may be compromised. The occurrence of any of such network or information systems-related events or security breaches could have a material adverse effect on our business, financial condition and results of operations.

The nature of our business exposes us to workers' compensation claims and other workplace liabilities.

Certain materials we use require our employees to handle potentially hazardous or toxic substances. While our employees who handle these and other potentially hazardous or toxic materials receive specialized training and wear protective clothing, there is still a risk that they, or others, may be exposed to these substances. Exposure to these substances could result in significant injury to our employees and damage to our property or the property of others, including natural resource damage. Our personnel are also at risk for other workplace-related injuries, including slips and falls. We have in the past been, and may in the future be, subject to fines, penalties, and other liabilities in connection with any such injury or damage. Although we currently maintain what we believe to be suitable and adequate insurance in excess of our self-insured amounts, we may be unable to maintain such insurance on acceptable terms or such insurance may not provide adequate protection against potential liabilities.

Our international markets require significant management attention, expose us to difficulties presented by international economic, political, legal and business factors, and may not be successful or produce desired levels of sales and profitability.

We currently sell our products throughout the world. Our total sales outside North America were less than 10% of our total revenue for fiscal years 2016, 2015 and 2014. International markets have been, and will continue to be, a focus for sales growth. We believe many opportunities exist in the international markets, and over time we intend for international sales to comprise a larger percentage of our total revenue. Several factors, including weakened international economic conditions, could adversely affect such growth. The expansion of our existing international operations and entry into additional international markets require significant management attention. Some of the countries in which we market and our distributors or licensee sell our products are to some degree subject to political, economic or social instability. Our international operations expose us and our representatives, agents and distributors to risks inherent in operating in foreign jurisdictions. These risks include, but are not limited to:

- increased costs of customizing products for foreign countries;
- unfamiliarity with local demographics, consumer preferences and discretionary spending patterns;
- difficulties in attracting customers due to a reduced level of customer familiarity with our brand;
- competition with new, unfamiliar competitors;
- the imposition of additional foreign governmental controls or regulations, including rules relating to environmental, health and safety matters and regulations and other laws applicable to publicly-traded companies, such as the Foreign Corrupt Practices Act, or the FCPA;
- new or enhanced trade restrictions and restrictions on the activities of foreign agents, representatives and distributors;
- the imposition of increases in costly and lengthy import and export licensing and other compliance requirements, customs duties and tariffs, license obligations and other non-tariff barriers to trade;
- laws and business practices favoring local companies;
- longer payment cycles and difficulties in enforcing agreements and collecting receivables through certain foreign legal systems; and

- difficulties in enforcing or defending intellectual property rights.

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Our international operations may not produce desired levels of total sales, or one or more of the foregoing factors may harm our business, financial condition or results of operations.

Changes in currency exchange rates can adversely affect our results.

A portion of our sales are denominated in a currency other than the U.S. dollar. Consequently, a strong U.S. dollar may adversely affect reported revenues. We also maintain a portion of our manufacturing operations in Australia which partially mitigates the impact of a strengthening U.S. dollar in that country. A portion of our SG&A costs are transacted in Australian dollars as a result. We also sell U.S. manufactured products into certain international markets in U.S. dollars, including the sale of products into Canada, Europe and Latin America. Demand for our products in these markets may also be adversely affected by a strengthening U.S. dollar. For example, we have experienced decreased demand in Canada due to the weakening Canadian dollar and demand is weak in other areas of the world, notably South America, South Africa and Europe. We do not currently use hedging or other derivative instruments to mitigate our foreign currency risks.

An increase in energy and fuel costs may adversely affect our business, financial condition and results of operations.

Higher energy costs result in increases in operating expenses at our manufacturing facility and in the expense of shipping products to our dealers. In addition, increases in energy costs may adversely affect the pricing and availability of petroleum-based raw materials, such as resins and foams, that are used in our products. Also, higher fuel prices may have an adverse effect on demand for our boats, as they increase the cost of ownership and operation.

We are subject to U.S. and other anti-corruption laws, trade controls, economic sanctions and similar laws and regulations, including those in the jurisdictions where we operate. Our failure to comply with these laws and regulations could subject us to civil, criminal and administrative penalties and harm our reputation.

Doing business on a worldwide basis requires us to comply with the laws and regulations of various foreign jurisdictions. These laws and regulations place restrictions on our operations, trade practices, partners and investment decisions. In particular, our operations are subject to U.S. and foreign anti-corruption and trade control laws and regulations, such as the FCPA, export controls and economic sanctions programs, including those administered by the U.S. Treasury Department's Office of Foreign Assets Control, or the OFAC. As a result of doing business in foreign countries and with foreign partners, we are exposed to a heightened risk of violating anti-corruption and trade control laws and sanctions regulations.

The FCPA prohibits us from providing anything of value to foreign officials for the purposes of obtaining or retaining business or securing any improper business advantage. It also requires us to keep books and records that accurately and fairly reflect our transactions.

Economic sanctions programs restrict our business dealings with certain sanctioned countries, persons and entities. In addition, because we act through dealers and distributors, we face the risk that our dealers, distributors or consumers might further distribute our products to a sanctioned person or entity, or an ultimate end-user in a sanctioned country, which might subject us to an investigation concerning compliance with OFAC or other sanctions regulations.

Violations of anti-corruption and trade control laws and sanctions regulations are punishable by civil penalties, including fines, denial of export privileges, injunctions, asset seizures, debarment from government contracts and revocations or restrictions of licenses, as well as criminal fines and imprisonment. We cannot assure you that all of our local, strategic or joint partners will comply with these laws and regulations, in which case we could be held liable for actions taken inside or outside of the United States, even though our partners may not be subject to these laws. Such a violation could materially and adversely affect our reputation, business, results of operations and financial condition.

Our continued international expansion, including in developing countries, and our development of new partnerships and joint venture relationships worldwide, could increase the risk of FCPA or OFAC violations in the future.

If we are unable to comply with environmental and other regulatory requirements, our business may be exposed to material liability or fines.

Our operations are subject to extensive regulation, including product safety, environmental and health and safety requirements, under various federal, state, local and foreign statutes, ordinances and regulations. While we believe that we are in material compliance with all applicable federal, state, local and foreign regulatory requirements, we cannot assure you that we will be able to continue to comply with applicable regulatory requirements. The failure to comply with applicable regulatory requirements could cause us to incur significant fines or penalties, obligations to conduct remedial or corrective actions, or, in extreme circumstances, revocation of our permits or injunctions preventing some or all of our operations. In addition, the components of our boats must meet certain regulatory standards, including stringent air emission standards for boat engines and fuel systems. Failure to meet these standards could result in an inability to sell our boats in key markets,

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which would adversely affect our business. Moreover, compliance with these regulatory requirements could increase the cost of our products, which in turn, may reduce consumer demand, or could materially increase the cost of operations. In addition, legal requirements are constantly evolving, and changes in laws, regulations or policies, or changes in interpretations of the foregoing, could also increase our costs or create liabilities where none exists today.
As with boat construction in general, our manufacturing processes involve the use, handling, storage and contracting for recycling or disposal of hazardous substances and wastes. The failure to manage or dispose of such hazardous substances and wastes properly could expose us to material liability or fines, including liability for personal injury or property damage due to exposure to hazardous substances, damages to natural resources, or for the investigation and remediation of environmental conditions. Under certain environmental laws, we may be liable for remediation of contamination at sites where our hazardous wastes have been disposed or at our current or former facilities, regardless of whether such facilities are owned or leased or whether we caused the condition of contamination. Also, the components in our boats may become subject to more stringent environmental regulations. For example, boat engines and other emission producing components may be subject to more stringent emissions standards, which could increase the cost of our engines, components and our products, which, in turn, may reduce consumer demand for our products.
A natural disaster or other disruption at our manufacturing facilities could adversely affect our business, financial condition and results of operations.
We rely on the continuous operation of manufacturing facilities in Tennessee, California and Australia. Any natural disaster or other serious disruption to our facilities due to fire, flood, earthquake or any other unforeseen circumstances could adversely affect our business, financial condition and results of operations. The occurrence of any disruption at our manufacturing facilities may have an adverse effect on our productivity and profitability, during and after the period of the disruption. These disruptions may also cause personal injury and loss of life, severe damage to or destruction of property and equipment and environmental damage. Although we maintain property, casualty and business interruption insurance of the types and in the amounts that we believe are customary for the industry, we are not fully insured against all potential natural disasters or other disruptions to our manufacturing facilities.
Increases in income tax rates or changes in income tax laws or enforcement could have a material adverse impact on our financial results.
Changes in domestic and international tax legislation could expose us to additional tax liability. Although we monitor changes in tax laws and work to mitigate the impact of proposed changes, such changes may negatively impact our financial results. In addition, any increase in individual income tax rates, such as those implemented at the beginning of 2013, would negatively affect our potential consumers’ discretionary income and could decrease the demand for our products.
Our credit facilities contain covenants which may limit our operating flexibility; failure to comply with covenants may restrict our access to these.
In the past, we have relied upon our existing credit facilities to provide us with adequate liquidity to operate our business. The availability of borrowing amounts under our credit facilities are dependent upon compliance with the debt covenants set forth in our credit agreement. Violation of those covenants, whether as a result of operating losses or otherwise, could result in our lenders restricting or terminating our borrowing ability under our credit facilities. If our lenders reduce or terminate our access to amounts under our credit facilities, we may not have sufficient capital to fund our working capital and other needs and we may need to secure additional capital or financing to fund our operations or to repay outstanding debt under our credit facilities. We cannot assure you that we will be successful in ensuring our availability to amounts under our credit facilities or in connection with raising additional capital and that any amount, if raised, will be sufficient to meet our cash needs or on terms as favorable as have historically been available to us. If we are not able to maintain our borrowing availability under our credit facilities or raise additional capital when needed, our business and operations will be materially and adversely affected.
Our variable rate indebtedness subjects us to interest rate risk, which could cause our debt service obligations to increase significantly.
Borrowings under our credit facility are at variable rates of interest and expose us to interest rate risk. Interest rates are currently at historically low levels. If interest rates increase, our debt service obligations on the variable rate indebtedness will increase even though the amount borrowed remains the same, and our net income and cash flows,

including cash available for servicing our indebtedness, will correspondingly decrease. We manage our exposure to interest rate movements on our term loan through the use of an interest rate swap agreement on half of our term loan obligation outstanding at June 30, 2016, or $36.0 million. We have elected not to designate our interest rate swap as a hedge; therefore, changes in the fair value of the derivative instrument may cause volatility in our interest expense based on fluctuations in interest rates. The interest rate on the remaining $36.0 million of our outstanding term loan is unhedged. In the future, we may enter into similar interest rate swaps that involve the exchange of floating for fixed rate interest payments in order to reduce future interest rate volatility on the remaining unhedged portion of our term loan; however, there is no guarantee we may take such action and we may not fully mitigate our interest rate risk. A hypothetical 1% increase in LIBOR over the 1.52% floor could increase our annual interest expense and related cash flows by approximately $0.3 million based on the unhedged portion of the amounts outstanding under our credit facility as of June 30, 2016.

We are an "emerging growth company" and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our Class A Common Stock less attractive to investors.

We are an "emerging growth company" as defined in the Jumpstart Our Business Startups Act, or the JOBS Act. We have taken, and for as long as we continue to be an emerging growth company, we may choose to take, advantage of certain exemptions from various reporting requirements applicable to other public companies but not to emerging growth companies, which includes, among other things:

- exemption from the auditor attestation requirements under Section 404 of the Sarbanes-Oxley Act;
- reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements;
- exemption from the requirements of holding non-binding stockholder votes on executive compensation arrangements; and
- exemption from any public rules requiring mandatory audit firm rotation and auditor discussion and analysis and, unless the SEC otherwise determines, any future audit rules that may be adopted by the Public Company Accounting Oversight Board.

We could be an emerging growth company until the last day of the fiscal year following the fifth anniversary after our initial public offering (June 30, 2019) or until the earliest of (1) the last day of the fiscal year in which we have annual gross revenue of $1 billion or more, (2) the date on which we have, during the previous three-year period, issued more than $1 billion in non-convertible debt or (3) the date on which we are deemed to be a large accelerated filer under the federal securities laws. We will qualify as a large accelerated filer as of the first day of the first fiscal year after we have more than $700 million in outstanding common equity held by our non-affiliates. The value of our outstanding common equity will be measured each year on the last day of our second fiscal quarter.

Under the JOBS Act, emerging growth companies are also permitted to elect to delay adoption of new or revised accounting standards until companies that are not subject to periodic reporting obligations are required to comply, if such accounting standards apply to non-reporting companies. We have made an irrevocable decision to opt out of this extended transition period for complying with new or revised accounting standards.

We cannot predict if investors will find our Class A Common Stock less attractive if we rely on these exemptions. If some investors find our Class A Common Stock less attractive as a result, there may be less active trading market for our Class A Common Stock and our stock price may be more volatile.

Failure to maintain effective internal control over financial reporting or disclosure controls and procedures could have a material adverse effect on our business and stock price.

Section 404(a) of the Sarbanes-Oxley Act requires an annual management assessment of the effectiveness of our internal control over financial reporting. Management is similarly required to review disclosure controls, which are controls established to ensure that information required to be disclosed in SEC reports is recorded, processed, summarized and reported in a timely manner. Additionally, once we are no longer an emerging growth company, as defined by the JOBS Act, our independent registered public accounting firm will be required pursuant to Section 404(b) of the Sarbanes-Oxley Act to attest to the effectiveness of our internal control over financial reporting on an annual basis.

If we fail to maintain the adequacy of our internal controls, as such standards are modified, supplemented or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting. The existence of any material weakness could require management to devote significant time and incur significant expense to remediate any such material weakness and management may not be able to remediate any such material weakness in a timely manner. The existence of any material weakness in our internal control over financial reporting could also result in errors in our financial statements that could require us to restate our financial statements, cause us to fail to meet our reporting obligations, and cause stockholders to lose confidence in our reported financial information, all of which could materially and adversely affect our business and

stock price. In addition, if our independent registered public accounting firm is
unable to provide an unqualified attestation report on our internal controls after we cease to be an emerging growth company, investors could lose confidence in our financial information and the price of our stock could decline.

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Risks Related to Our Organizational Structure

Our only material asset is our interest in the LLC, and we are accordingly dependent upon distributions from the LLC to pay taxes, make payments under the tax receivable agreement or pay dividends.

Malibu Boats, Inc. is a holding company and has no material assets other than our ownership of LLC Units. Malibu Boats, Inc. has no independent means of generating revenue. We intend to cause the LLC to make distributions to its unit holders in an amount sufficient to cover all applicable taxes at assumed tax rates, payments under the tax receivable agreement and dividends, if any, declared by us. To the extent that we need funds, and the LLC is restricted from making such distributions under applicable law or regulation or under the terms of its financing arrangements, or is otherwise unable to provide such funds, it could materially adversely affect our liquidity and financial condition. For example, our credit agreement generally prohibits the LLC, Malibu Boats, LLC and Malibu Domestic International Sales Corp. from paying dividends or making distributions. Our credit agreement permits, however, distributions based on a member's allocated taxable income, distributions to fund payments that are required under the tax receivable agreement, payments pursuant to stock option and other benefit plans up to $2.0 million in any fiscal year, dividends and distributions within the loan parties and dividends payable solely in interests of classes of securities. In addition, the LLC may make dividends and distributions of up to $6.0 million in any fiscal year, subject to compliance with other financial covenants.

We will be required to pay the pre-IPO owners (or any permitted assignee) for certain tax benefits pursuant to our tax receivable agreement with them, and the amounts we may pay could be significant.

We entered into a tax receivable agreement with the pre-IPO owners (or their permitted assignees) that provides for the payment by us to the pre-IPO owners (or any permitted assignee) of 85% of the tax benefits, if any, that we are deemed to realize as a result of (1) the increases in tax basis resulting from our purchases or exchanges of LLC Units and (2) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement. These payment obligations are our obligations and not of the LLC. For purposes of the agreement, the benefit deemed realized by us will be computed by comparing our actual income tax liability (calculated with certain assumptions) to the amount of such taxes that we would have been required to pay had there been no increase to the tax basis of the assets of the LLC as a result of the purchases or exchanges, and had we not entered into the tax receivable agreement. Estimating the amount of payments that may be made under the tax receivable agreement is by its nature imprecise, insofar as the calculation of amounts payable depends on a variety of factors. The actual increase in tax basis, as well as the amount and timing of any payments under the agreement, will vary depending upon a number of factors, including:

- the timing of purchases or exchanges-for instance, the increase in any tax deductions will vary depending on the fair value, which may fluctuate over time, of the depreciable or amortizable assets of the LLC at the time of each purchase or exchange;
- the price of shares of our Class A Common Stock at the time of the purchase or exchange-the increase in any tax deductions, as well as the tax basis increase in other assets, of the LLC is directly related to the price of shares of our Class A Common Stock at the time of the purchase or exchange;
- the extent to which such purchases or exchanges are taxable-if an exchange or purchase is not taxable for any reason, increased deductions will not be available; and
- the amount and timing of our income-the corporate taxpayer will be required to pay 85% of the deemed benefits as and when deemed realized. If we do not have taxable income, we generally will not be required (absent a change of control or other circumstances requiring an early termination payment) to make payments under the tax receivable agreement for that taxable year because no benefit will have been realized. However, any tax benefits that do not result in realized benefits in a given tax year will likely generate tax attributes that may be utilized to generate benefits in previous or future tax years. The utilization of such tax attributes will result in payments under the tax receivable agreement.

For more information see "Item 1. Business - History and Formation Transactions" and Note 2 to our audited consolidated financial statements included elsewhere in this Annual Report.

We expect that the payments that we may make under the tax receivable agreement may be substantial. Assuming no material changes in the relevant tax law, and that we earn sufficient taxable income to realize all tax benefits that are subject to the agreement, we expect that future payments under the tax receivable agreement relating to the purchases by Malibu Boats, Inc. of LLC Units will be approximately $93.8 million over the next 19 years. Future payments to pre-IPO owners (or their permitted assignees) in respect of subsequent exchanges or purchases would be in addition to these amounts and are expected to be substantial. The foregoing numbers are merely estimates and the actual payments could differ materially. It is possible that

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future transactions or events could increase or decrease the actual tax benefits realized and the corresponding tax receivable agreement payments. There may be a material negative effect on our liquidity if distributions to us by the LLC are not sufficient to permit us to make payments under the tax receivable agreement after we have paid taxes. For example, we may have an obligation to make tax receivable agreement payments for a certain amount while receiving distributions from the LLC in a lesser amount, which would negatively affect our liquidity. The payments under the tax receivable agreement are not conditioned upon the pre-IPO owners' (or any permitted assignees') continued ownership of us.

We are required to make a good faith effort to ensure that we have sufficient cash available to make any required payments under the tax receivable agreement. The limited liability company agreement of the LLC requires the LLC to make "tax distributions" which, in the ordinary course, will be sufficient to pay our actual tax liability and to fund required payments under the tax receivable agreement. If for any reason the LLC is not able to make a tax distribution in an amount that is sufficient to make any required payment under the tax receivable agreement or we otherwise lack sufficient funds, interest would accrue on any unpaid amounts at the London Interbank Offered Rate, or LIBOR, plus 500 basis points until they are paid.

In certain cases, payments under the tax receivable agreement to the pre-IPO owners (or any permitted assignees) of LLC Units may be accelerated or significantly exceed the actual benefits we realize in respect of the tax attributes subject to the tax receivable agreement.

The tax receivable agreement provides that, in the event that we exercise our right to early termination of the tax receivable agreement, or in the event of a change in control or a material breach by us of our obligations under the tax receivable agreement, the tax receivable agreement will terminate, and we will be required to make a lump-sum payment equal to the present value of all forecasted future payments that would have otherwise been made under the tax receivable agreement, which lump-sum payment would be based on certain assumptions, including those relating to our future taxable income. The change in control payment and termination payments to the pre-IPO owners (or any permitted assignees) could be substantial and could exceed the actual tax benefits that we receive as a result of acquiring the LLC Units because the amounts of such payments would be calculated assuming that we would have been able to use the potential tax benefits each year for the remainder of the amortization periods applicable to the basis increases, and that tax rates applicable to us would be the same as they were in the year of the termination. In these situations, our obligations under the tax receivable agreement could have a substantial negative impact on our liquidity. There can be no assurance that we will be able to finance our obligations under the tax receivable agreement.

Payments under the tax receivable agreement will be based on the tax reporting positions that we determine. Although we are not aware of any issue that would cause the Internal Revenue Service, or the IRS, to challenge a tax basis increase, Malibu Boats, Inc. will not be reimbursed for any payments previously made under the tax receivable agreement. As a result, in certain circumstances, payments could be made under the tax receivable agreement in excess of the benefits that Malibu Boats, Inc. actually realizes in respect of (1) the increases in tax basis resulting from our purchases or exchanges of LLC Units and (2) certain other tax benefits related to our entering into the tax receivable agreement, including tax benefits attributable to payments under the tax receivable agreement.

Risks Related to Our Class A Common Stock

Our stock price may be volatile and stockholders may be unable to sell shares at or above the price at which they purchased them.

Our stock price ranged from $11.38 per share to $21.47 per share during fiscal year 2016. The market price of our Class A Common Stock could be subject to wide fluctuations in response to the many risk factors listed in this section, and others beyond our control, including:

- general economic, market and industry conditions;
- actual or anticipated fluctuations in our financial condition and results of operations;
- addition or loss of consumers or dealers;
- actual or anticipated changes in our rate of growth relative to our competitors;
- additions or departures of key personnel;
- failure to introduce new products, or for those products to achieve market acceptance;

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- disputes or other developments related to proprietary rights, including patents, litigation matters and our ability to obtain intellectual property protection for our technologies;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- fluctuations in the valuation of companies perceived by investors to be comparable to us;
- changes in applicable laws or regulations;
- issuance of new or updated research or reports by securities analysts;
- sales of our Class A Common Stock by us or our stockholders;
- share price and volume fluctuations attributable to inconsistent trading volume levels of our shares; and
- the expiration of contractual lock-up agreements with our executive officers, directors and stockholders.

Further, the stock markets may experience extreme price and volume fluctuations that can affect the market prices of equity securities. These fluctuations can be unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, could harm the market price of our Class A Common Stock.

In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management’s attention from other business concerns, which could harm our business.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

The trading market for our Class A Common Stock will depend on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish research or reports on us, we could lose visibility in the financial markets, which could cause our stock price or trading volume to decline.

Our governing documents and Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our certificate of incorporation and bylaws contain certain provisions that could delay or prevent a change in control. These provisions could also make it more difficult for stockholders to elect directors and take other corporate actions. These provisions include, without limitation:

- a classified board structure;
- a requirement that stockholders must provide advance notice to propose nominations or have other business considered at a meeting of stockholders;
- supermajority stockholder approval to amend our bylaws or certain provisions in our certificate of incorporation; and
- authorization of blank check preferred stock.

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding Class A Common Stock, from engaging in certain business combinations without the approval of substantially all of our stockholders for a certain period of time.

These and other provisions in our certificate of incorporation, bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our Class A Common Stock in the future and result in the market price being lower than it would be without these provisions.

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We currently do not intend to pay dividends on our Class A Common Stock and, consequently, the only opportunity for stockholders to achieve a return on their investment is if the price of our Class A Common Stock appreciates.
We currently do not plan to declare or pay dividends on shares of our Class A Common Stock in the foreseeable future. Further, because we are a holding company, our ability to pay dividends depends on our receipt of cash distributions from the LLC and the LLC also relies on its subsidiaries for receipt of cash for distributions. This may further restrict our ability to pay dividends as a result of the laws of the jurisdiction of organization of the LLC and its subsidiaries, agreements of the LLC or its subsidiaries or covenants under our, the LLC’s or its subsidiaries’ existing or future indebtedness. For example, our credit agreement generally prohibits the LLC, Malibu Boats, LLC and Malibu Domestic International Sales Corp. from paying dividends or making distributions. Our credit agreement permits, however, distributions based on a member’s allocated taxable income, distributions to fund payments that are required under the tax receivable agreement, payments pursuant to stock option and other benefit plans, dividends and distributions within the loan parties and dividends payable solely in interests of classes of securities. In addition, the LLC may make dividends and distributions of up to $6.0 million in any fiscal year, subject to compliance with other financial covenants. Consequently, for stockholders the only opportunity to achieve a return on the shares they purchase will be if the market price of our Class A Common Stock appreciates and they sell their shares at a profit.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

Tennessee

Our boats are manufactured and tested on the lake at the site of our 197,300 square-foot primary manufacturing facility located in Loudon, Tennessee. Our primary facility is leased pursuant to a lease agreement that has a term through March 31, 2028, with the option to extend for three additional terms of ten years each. We also lease 23,460 square feet of warehouse and office space located in Loudon pursuant to a lease agreement that has a term through December 31, 2016, with an additional renewal term of two years.
On April 1, 2016, we completed an addition to our warehouse and loading facility on 16 acres of land we own in Loudon, Tennessee. The facility contains approximately 42,000 square feet of production, warehouse and office space and is used primarily for trailer manufacturing and handling and shipping of our finished boats. These facilities are used in our U.S. segment.

California

We lease a 172,500 square-foot facility in Merced, California pursuant to a lease agreement that has a term through March 31, 2028, with the option to extend for three additional terms of ten years each. Our Merced site houses both our product development team that focuses on design innovations as well as our tower and tower accessory manufacturing operations. The components assembled at this site are delivered to our facilities in Tennessee and our Australian licensee. Our Merced site is used in both our U.S. and Australia segments.

Australia

We manufacture and test boats at two facilities in Albury, Australia with combined square-footage of 68,222. Each facility is leased pursuant to a lease agreement and each with a term through October 22, 2024, with two 5-year options to extend lease term. These facilities are used in our Australia segment.

Item 3. Legal Proceedings

The discussion of legal matters under the section entitled "Legal Proceedings" is incorporated by reference from Note 16 of our audited consolidated financial statements included elsewhere in this Annual Report.

Item 4. Mine Safety Disclosures

Not Applicable.

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PART II.

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information

Our Class A Common Stock has been listed on the NASDAQ Global Select Market under the symbol "MBUU" since January 31, 2014. Prior to that date, there was no public trading market for our Class A Common Stock. The following table sets forth, for the periods indicated, the high and low sales prices of our Class A Common Stock as reported by the NASDAQ Global Select Market since our initial public offering:

	High	Low
Fiscal Year 2015		
First Quarter	$21.88	$17.14
Second Quarter	$19.49	$16.16
Third Quarter	$23.58	$18.20
Fourth Quarter	$24.14	$19.55
Fiscal Year 2016		
First Quarter	$21.47	$13.57
Second Quarter	$16.83	$12.90
Third Quarter	$16.71	$11.97
Fourth Quarter	$18.08	$11.38

On September 8, 2016, the last reported sale price on the NASDAQ Global Select Market of our Class A Common Stock was $15.18 per share. As of September 8, 2016, we had approximately five holders of record of our Class A Common Stock and 23 holders of record of our Class B Common Stock. The actual number of stockholders is greater than this number of record holders, and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers and other nominees. This number of holders of record also does not include stockholders whose shares may be held in trust by other entities.

Dividends

Malibu Boats, Inc. has never declared or paid any cash dividends on its capital stock. We currently anticipate that we will retain all of our future earnings for use in the expansion and operation of our business and do not anticipate paying any cash dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to applicable law and will depend on our financial condition, results of operations, capital requirements, general business conditions and other factors that our board of directors may deem relevant. In addition, our credit facility restricts our ability to pay dividends on our capital stock in certain cases.

Malibu Boats, Inc. is a holding company and has no material assets other than its ownership of LLC Units. We intend to cause the LLC to make distributions to us in an amount sufficient to cover cash dividends, if any, declared by us. If the LLC makes such distributions to Malibu Boats, Inc., the other holders of LLC Units will be entitled to receive equivalent distributions on a pro rata basis.

The credit agreement governing our credit facility generally prohibits the LLC and our other subsidiaries from paying dividends or making distributions to us. However, our credit agreement currently permits the LLC to make dividends and distributions to us of up to $6.0 million in any fiscal year for any reason and to make dividends and distributions of up to $15.0 million in connection with our stock repurchase program, in each case, subject to compliance with other financial covenants.

Stock Performance Graph

The stock price performance graph below shall not be deemed soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Exchange Act or to the liabilities of Section 18 of the Exchange Act, nor shall it be incorporated by reference into any past or future filing under the Securities Act of 1933, as amended, or the Securities Act or

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the Exchange Act, except to the extent we specifically request that it be treated as soliciting material or specifically incorporate it by reference into a filing under the Securities Act or the Exchange Act.

The following graph shows the cumulative total stockholder return of an investment of $100 in cash at market close on January 31, 2014 (the first day of trading of our Class A Common Stock), through June 30, 2016 for (i) our Class A Common Stock and (ii) performance of the Russell 2000 Index and Recreational Vehicle Index for the same period. Pursuant to applicable SEC rules, all values assume reinvestment of the full amount of all dividends, however no dividends have been declared on our Class A Common Stock to date. The stockholder return shown on the graph below is not necessarily indicative of future performance, and we do not make or endorse any predictions as to future stockholder returns.

Issuer Purchases of Equity Securities

The table below sets forth the information with respect to purchases made by or on behalf of Malibu Boats, Inc. of its own stock during the fourth quarter of the fiscal year ended June 30, 2016.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program (1) (Dollars in millions)
April	—	$ —	—	$ 14.2
May	231,600	$ 13.67	231,600	$ 11.0
June	—	$ —	—	$ 11.0

(1) Our board of directors authorized the stock repurchase program (the "Repurchase Program") for the repurchase of up to $15.0 million of Class A Common Stock and the LLC's LLC Units for the period from February 8, 2016 to February 8, 2017. The Repurchase Program was publicly announced on February 4, 2016. Upon repurchase, the shares were classified as treasury stock and then subsequently retired. In accordance with the LLC Agreement, in connection with any repurchases by us under the Repurchase Program, the LLC must redeem an equal number of LLC Units held by us as shares of Class A Common Stock repurchased by us at a redemption price equal to the redemption price paid for the Class A Common Stock repurchased by us. As of June 30, 2016, we purchased a total of 287,346 shares of Class A Common Stock at an average stock price of $13.82 per share for an aggregate purchase price of approximately $4.0 million including related fees and expenses. In addition, 287,346 LLC Units held by us were redeemed and canceled by the LLC.

Equity Compensation Plan Information

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Equity compensation plan information required by this Item 5 will be included in our definitive proxy statement for our annual meeting of stockholders, which will be filed with the SEC no later than 120 days after the end of our fiscal year ended June 30, 2016 (the "Proxy Statement"), and is incorporated herein by reference.

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Item 6. Selected Financial Data

The following table presents our selected financial data. The table should be read in conjunction with "Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations," and "Item 8. Financial Statements and Supplementary Data," of this Annual Report on Form 10-K.

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	Fiscal Year Ended June 30,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Consolidated statement of operations and comprehensive income (loss) data:					
Net sales	$252,965	$228,621	$190,935	$167,012	$140,892
Cost of sales	186,145	168,192	140,141	123,412	110,849
Gross profit	66,820	60,429	50,794	43,600	30,043
Operating expenses:					
Selling and marketing	7,475	7,007	6,098	4,937	4,071
General and administrative	21,256	19,809	39,974	14,177	8,307
Amortization	2,185	2,463	5,177	5,178	5,178
Operating income (loss)	35,904	31,150	(455)	19,308	12,487
Other income (expense), net	(3,808)	696	(2,953)	(1,324)	(1,381)
Net income (loss) before income tax expense (benefit)	32,096	31,846	(3,408)	17,984	11,106
Income tax expense (benefit)	11,801	8,663	(2,220)	—	—
Net income (loss)	20,295	23,183	(1,188)	17,984	11,106
Net income attributable to non-controlling interest [1]	2,253	8,522	3,488	17,984	11,106
Net income (loss) attributable to Malibu Boats, Inc.	$18,042	$14,661	$(4,676)	$—	$—
Net income (loss) available to Class A Common Stock per share [2]:			For Period from February 5, 2014 to June 30, 2014		
Basic	$1.01	$0.93	$(0.42)		
Diluted	$1.00	$0.93	$(0.42)		
Weighted average shares outstanding used in computing net income (loss) per share:					
Basic	17,934,580	15,732,531	11,055,310		
Diluted	17,985,427	15,741,018	11,055,310		
Consolidated balance sheet data:					
Total assets	$220,530	$200,314	$84,801	$65,927	$64,725
Total liabilities	202,297	199,029	56,731	45,913	39,280
Total stockholders'/members' equity	18,233	1,285	28,070	20,014	25,445
Additional financial and other data:					
Unit volume	3,569	3,404	2,910	2,672	2,482
Gross margin	26.4%	26.4%	26.6%	26.1%	21.3%
Adjusted EBITDA [3]	$48,231	$43,648	$37,272	$31,758	$19,863
Adjusted EBITDA margin [3]	19.1%	19.1%	19.5%	19.0%	14.1%
Adjusted fully distributed net income per share [3]	$1.32	$1.11	$0.78	$0.68	$0.35

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(1) For the period after the IPO on February 5, 2014, the non-controlling interest represents the portion of earnings or (loss) attributable to the economic interest held by the non-controlling LLC Unit holders. The weighted average non-controlling interest attributable to ownership interests in the LLC was 11.1%, 36.8% and 50.7% for the fiscal years ended June 30, 2016 and 2015 and for the period from February 5, 2014 (the date of our IPO) to June 30, 2014, respectively. The non-controlling interest was 7.4% as of June 30, 2016 and 2015 and 50.7% as of June 30, 2014, respectively. Since all of the earnings prior to and up to February 5, 2014 were entirely allocable to the LLC Unit holders, we updated our historical presentation to attribute these earnings to the non-controlling interest accordingly.

(2) As noted above, all earnings (loss) prior and up to February 5, 2014, the date of completion of the IPO, were entirely allocable to the non-controlling interest. As a result, earnings (loss) per share information attributable to these historical periods is not comparable to earnings (loss) per share information attributable to the Company after the IPO and, as such, has been omitted.

(3) Adjusted EBITDA, adjusted EBITDA margin, and adjusted fully distributed net income per share are non-GAAP financial measures. For definitions of adjusted EBITDA, adjusted EBITDA margin, and adjusted fully distributed net income and a reconciliation of each to net income, see “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations-GAAP Reconciliation of Non-GAAP Financial Measures.”

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Some of the information in this Annual Report on Form 10-K includes “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. All statements other than statements of historical facts included in this Form 10-K, including, without limitation, certain statements under this “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, may constitute forward-looking statements. In some cases you can identify these “forward-looking statements” by words like “may,” “will,” “should,” “expects “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of those words and other comparable words. Any such forward-looking statements are not guarantees of future performance and involve risks, uncertainties and other factors that may cause our actual results, performance or achievements, or industry results to vary materially from our future results, performance or achievements, or those of our industry, expressed or implied in such forward-looking statements. Such factors include, among others, general industry, economic and business conditions, demand for our products, changes in consumer preferences, competition within our industry, our reliance on our network of independent dealers, our ability to manage our manufacturing levels and our large fixed cost base, and the successful introduction of our new products, as well as other factors affecting us discussed under the heading “Item 1A. Risk Factors” in this Form 10-K. Many of these risks and uncertainties are outside our control, and there may be other risks and uncertainties which we do not currently anticipate because they relate to events and depend on circumstances that may or may not occur in the future. We do not intend and undertake no obligation to update any forward-looking information to reflect actual results or future events or circumstances.

Overview

We are a leading designer, manufacturer and marketer of performance sport boats, having the #1 market share position in the United States since 2010. Our boats are used for water sports, including water skiing, wakeboarding and wake surfing, as well as general recreational boating. We earn revenue and generate profits from the sale of our high performance boats under two brands—Malibu and Axis. Our flagship Malibu brand boats offer our latest innovations in performance, comfort and convenience, and are designed for consumers seeking a premium boating experience. Our Axis brand of boats is designed to appeal to consumers who desire a more affordable product but still demand high performance, functional simplicity and the option to upgrade key features.

Since inception in 1982, we believe we have been a consistent innovator in the powerboat industry, designing products that appeal to an expanding range of recreational boaters and water sports enthusiasts whose passion for boating and water sports is a key aspect of their lifestyle. We continue to focus on innovation and invest in product development to expand the market for our products by introducing consumers to new and exciting recreational activities. We believe that our boats are increasingly versatile, allowing consumers to use them for a wide range of activities that enhance the experience of a day on the water with family and friends. While there is no guarantee that we will achieve market share growth in the future, we believe that the

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performance, quality, value and multi-purpose features of our boats position us to achieve our goal of increasing our market share in the expanding recreational boating market.

We offer our boats for sale through an extensive network of independent dealers in North America and throughout the world. As of July 1, 2016, our distribution channel consisted of 110 independent dealers in North America operating 147 locations and we had 58 independent dealer locations across 38 countries outside of North America, including Australia. Our boats are the exclusive performance sport boats offered by the majority of our dealers. Additionally, we offered our boats through an exclusive licensee in Australia that is one of the largest performance sport boat manufacturers in that country until October 23, 2014, at which time we acquired it and it became our subsidiary. Following the acquisition, the results of our Australian operations are included in our consolidated financial results. See Note 4 of our consolidated financial statements for more information. Our dealer base is an important part of our consumers' experience, our marketing efforts and our brands. We devote significant time and resources to find, develop and improve the performance of our dealers and believe our dealer network gives us a distinct competitive advantage.

We have undergone significant growth since we were founded in 1982 and began building custom ski boats in a small shop in Merced, California. In 2006, we were acquired by an investor group, including affiliates of Black Canyon Capital LLC, Horizon Holdings, LLC and then-current management. Beginning in 2009, under the leadership of new management, we implemented several measures designed to improve our cost structure, increase our operating leverage, enhance our product offerings and brands, and strengthen our dealer network. Jack Springer, our Chief Executive Officer, and Wayne Wilson, our Chief Financial Officer, helped lead us successfully through the volume declines experienced during the economic recession. Despite the downturn, we continued to build on our legacy of innovation and invested in product development and process improvements. For example, we:

- introduced the Axis brand in 2009 for consumers seeking a performance sport boat at a more affordable price;
- acquired Titan Wake Accessories in 2009 in order to bring tower manufacturing in-house, and subsequently designed and introduced the G3/G4 Tower;
- released the first picklefork bow design under the Malibu brand in 2012 to fill a specific gap within our product portfolio, quickly followed by two additional Malibu picklefork models;
- enhanced our manufacturing efficiencies through process improvements and product engineering, including moving from batch to continuous flow manufacturing;
- introduced our patented Surf Gate technology in 2012, which allows users to surf on either side of the boat's wake, generates a better quality surf wave and was the Watersports Industry Association's Innovation of the Year in 2013; and
- integrated the manufacturing of our own trailers beginning with model year 2016, including full trailer design and construction which provides greater customization and quality control.

In addition, we initiated a disciplined process of reviewing, assessing and expanding our dealer network. We have consistently grown and improved our dealer network worldwide since our new management team joined in fiscal year 2010. During this period, we initiated a more disciplined approach of monitoring dealer inventory levels relative to market demand in order to align annual production levels more closely with annual retail sales levels at our dealers.

As a result of these collective initiatives, we have a rationalized cost base with a high growth product portfolio that achieved fiscal year 2016 net sales, net income (loss) and adjusted EBITDA of $253.0 million, $20.3 million and $48.2 million, respectively, compared to $228.6 million, $23.2 million and $43.6 million, respectively, for fiscal year 2015 and $190.9 million, $(1.2) million and $37.3 million, respectively, for fiscal year 2014. For the fiscal year ended June 30, 2016, net sales increased 10.6%, gross margin as a percentage of sales remained flat at 26.4%, net income decreased 12.5% and adjusted EBITDA increased 10.5% compared to the fiscal year ended June 30, 2015. Our results for fiscal years 2016 and 2015 include our Australian licensee since its acquisition on October 23, 2014. The decrease in net income was largely due to an increase in interest expense attributable to our term debt, interest on our interest rate swap arrangement and change in the fair value of our interest rate swap we entered into on July 1, 2015. For the definition of adjusted EBITDA and a reconciliation to net income (loss), see "—GAAP Reconciliation of Non-GAAP Financial Measures."

Malibu Boats, Inc. is a Delaware corporation with its principal offices in Loudon, Tennessee. We use the terms "Malibu Boats," the "Company," "we," "us," "our" or similar references to refer to (i) Malibu Boats Holdings, LLC, or the LLC and its consolidated subsidiaries prior to the Recapitalization and IPO of Malibu Boats, Inc.'s Class A Common Stock as described under "Item 1. Business—History and Formation Transactions" and (ii) Malibu Boats, Inc. and its consolidated subsidiaries after the Recapitalization and IPO, which were completed on February 5, 2014.

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Components of Results of Operations

Net Sales

We generate revenue from the sale of boats to our dealers. The substantial majority of our net sales are derived from the sale of boats, including optional features included at the time of the initial wholesale purchase of the boat. Net sales consists of the following:

- Gross sales from:
- Boat sales—consists of sales of boats to our dealer network. In addition, nearly all of our boat sales include optional feature upgrades purchased by the consumer, such as Surf Gate, which increase the average selling price of our boats;
- Trailers, parts and accessories sales—consists of sales of boat trailers and replacement and aftermarket boat parts and accessories to our dealer network. Part sales to our Australian operations recognized after the acquisition date of our Australian licensee are eliminated in consolidation; and
- Royalty income—consists of licensing fees and royalties that were earned prior to the closing date of our Australia licensee acquisition. The licensee had the exclusive right to manufacture and distribute our products in Australia and New Zealand. Royalty income earned after the acquisition date is eliminated in consolidation. Also included are royalties attributable to license agreements with various boat manufacturers, including Nautique Boat Company, Inc. ("Nautique"), in connection with our settlement of litigation with Nautique in fiscal year 2015.
- Net sales are net of:
- Sales returns—consists primarily of contractual repurchases of boats either repossessed by the floor plan financing provider from the dealer or returned by the dealer under our warranty program; and
- Rebates, free flooring and discounts—consists of incentives, including rebates and free flooring, we provide to our dealers based on sales of eligible products. If a dealer meets its annual commitment volume as well as other terms of the rebate program, the dealer is entitled to a specified rebate. Our dealers that take delivery of current model year boats in the offseason, typically July through April in the U.S., are entitled to have us pay the interest to floor the boat until the earlier of (1) the sale of the unit or (2) a date near the end of the current model year, which incentive we refer to as “free flooring.” For more information, see "Item 1. Business - Dealer Management."

Cost of Sales

Our cost of sales includes all of the costs to manufacture our products, including raw materials, components, supplies, direct labor and factory overhead. For components and accessories manufactured by third-party vendors, such costs represent the amounts invoiced by the vendors. Shipping costs and depreciation expense related to manufacturing equipment and facilities are also included in cost of sales. Warranty costs associated with the repair or replacement of our boats under warranty are also included in cost of sales.

Operating Expenses

Our operating expenses include selling and marketing, and general and administrative costs. Each of these items includes personnel and related expenses, supplies, non-manufacturing overhead, third-party professional fees and various other operating expenses. Further, selling and marketing expenditures include the cost of advertising and various promotional sales incentive programs. General and administrative expenses include, among other things, salaries, benefits and other personnel related expenses for employees engaged in product development, engineering, finance, information technology, human resources, litigation settlement expense and executive management. Other costs include outside legal and accounting fees, investor relations, risk management (insurance) and other administrative costs.

Other Income (Expense), Net

Other income (expense), net consists of interest expense and other income or expense, net. Interest expense consists of interest charged under our outstanding debt, interest on our interest rate swap arrangement, change in the fair value of our interest rate swap we entered into on July 1, 2015, amortization of deferred financing costs on our credit facilities, debt issuance costs written off in connection with the pay down of all the amounts owed under our prior credit facilities and term loans with the proceeds from our IPO and related settlement of our interest rate swap. Other income includes a portion of the amounts received from the settlement of our litigation with Nautique entered into on February 6, 2015.

Income Taxes

Malibu Boats, Inc. is subject to U.S. federal and state income tax in multiple jurisdictions with respect to our allocable share of any net taxable income of the LLC after the IPO on February 5, 2014. The LLC is a pass-through entity for federal purposes but incurs income tax in certain state jurisdictions. The income tax provision (benefit) reflects a reported effective income tax rate of 36.8%, 27.2% and 65.2% attributable to Malibu Boats, Inc.'s share of income (loss) after the completion of the IPO for fiscal years 2016, 2015 and 2014, respectively. The reported effective tax rates differ from the statutory federal income tax rate of 35% primarily due to the impact of the non-controlling interest and state income taxes attributable to the LLC, including the benefit of deductions under Section 199 of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code") and the impact of an out-of-period tax adjustment associated with benefits recognized for the Tennessee jobs tax credit for fiscal year 2015. Our effective tax rates also reflect the impact of state taxes and our share of the LLC's permanent items such as stock compensation expense attributable to profits interests, the domestic production activities deduction, nondeductible offering costs for fiscal years 2015 and 2014 and acquisition related costs for fiscal year 2015.

Net Income Attributable to Non-controlling Interest

As of June 30, 2016 and 2015, we had a 92.6% controlling economic interest and 100% voting interest in the LLC. As of June 30, 2014, we had a 49.3% controlling economic interest and 100% voting interest in the LLC. We therefore consolidate the LLC's operating results for financial statement purposes. Net income or (loss) attributable to non-controlling interest represents the portion of net income or (loss) attributable to the LLC members.

Recapitalization, IPO and Equity Transactions

Recapitalization and IPO

Immediately prior to the closing of the IPO of Malibu Boats, Inc. on February 5, 2014, a new single class of LLC Units was allocated among the pre-IPO owners of the LLC in exchange for their prior membership interests of the LLC based upon the liquidation value of the LLC, assuming it was liquidated at the time of the IPO with a value implied by the initial public offering price of the shares of Class A Common Stock sold in the IPO. Immediately prior to the closing of the IPO, there were 17,071,424 LLC Units issued and outstanding.

Further, on February 4, 2014 (prior to the closing of the IPO), two holders of membership interests in the LLC merged with and into two newly formed subsidiaries of Malibu Boats, Inc. As a result of these mergers, the sole stockholders of each of the two merging entities received shares of Class A Common Stock in exchange for shares of capital stock of the merging entities. Also, we redeemed for nominal consideration, the initial 100 shares of Class A Common Stock issued to our initial stockholder in connection with our formation.

We refer to the foregoing transactions as the “Recapitalization.”

On February 5, 2014, we completed our initial public offering of 8,214,285 shares of Class A Common Stock, of which 7,642,996 shares were issued and sold by us and 571,289 shares were sold by selling stockholders. We received $99.5 million and the selling stockholders received $7.4 million net proceeds from the IPO. With the proceeds we received, approximately $29.8 million was used to purchase LLC Units directly from the pre-IPO owners and $69.8 million was used to purchase newly issued LLC Units from the LLC, which the LLC then used (i) to pay down all of the amounts owed under the LLC’s credit facilities and term loans in the amount of $63.4 million, (ii) to pay Malibu Boats Investor, LLC, an affiliate of the LLC, a fee of $3.8 million in connection with the termination of the LLC’s management agreement upon consummation of the IPO, and (iii) for general corporate purposes with the remaining approximately $2.7 million. In connection with the repayment of the LLC’s credit facilities and term loans, debt issuance costs associated with the term loans were written off to interest expense.

Offerings

Since the IPO, we have engaged in significant transactions involving our equity.

On July 15, 2014, we completed a follow-on public offering of 5,520,000 shares of our Class A Common Stock, of which 4,371,893 shares were issued and sold by us and 1,148,107 shares were sold by selling stockholders. The aggregate gross proceeds from the follow-on offering were $102.1 million. Of these proceeds, we received $76.8 million and the selling stockholders received $20.2 million, after deducting $5.1 million in underwriting discounts and commissions. We used all of the proceeds we received to purchase LLC Units directly from the holders of LLC Units.

On March 13, 2015, Malibu Boats, Inc. commenced an offer to purchase up to $70.0 million in value of shares of its Class A Common Stock, including shares of Class A Common Stock issued upon exchange of LLC Units, for cash by means of a “modified Dutch auction” tender offer (the "Tender Offer"). Upon completion of the Tender Offer, on April 15, 2015, we purchased 3,333,333 shares of Class A Common Stock, including 2,602,923 shares of Class A Common Stock that were issued upon the exchange of LLC Units, at a purchase price of $21.00 per share for an aggregate purchase price of approximately $70.0 million, excluding related fees and expenses of approximately $1.5 million related to the Tender Offer.

On May 27, 2015, we completed a secondary offering of 3,996,255 shares of our Class A Common Stock, including 2,967,267 shares of Class A Common Stock that were issued upon the exchange of LLC Units, all of which were sold by selling stockholders. Affiliates of Black Canyon Capital, LLC sold the remainder of their outstanding shares of Class A Common Stock, including LLC Units that they exchanged for Class A Common Stock, in this offering.

Stock Repurchase Program

On February 1, 2016, our board of directors authorized a stock repurchase program to allow for the repurchase of up to $15.0 million of the Company’s Class A Common Stock and the LLC's LLC Units for the period from February 8, 2016 to February 8, 2017. During fiscal year 2016, we purchased 287,346 shares of Class A Common Stock at an average stock price of $13.82 per share for an aggregate purchase price of approximately $4.0 million including related fees and expenses. Upon repurchase, these shares were classified as treasury stock and then subsequently retired. In addition, 287,346 LLC Units held by us were redeemed and canceled by the LLC. As of June 30, 2016, we may repurchase up to an additional $11.0 million in shares of Class A Common Stock and LLC Units under the program.

Outlook

Although industry-wide retail boat sales remain lower than they were in 2007, prior to the financial crisis, sales volumes expanded during fiscal years 2015 and 2016. According to Statistical Surveys, Inc., domestic retail registrations of performance sport boats increased approximately 10% in 2015, 16% in 2014, 12% in 2013 and 12% in 2012, for the 50 reporting states. Domestic retail demand growth has continued for calendar year 2016, however, we believe the pace is not as strong as that of calendar years 2012 through 2015. We expect the growing demand for our product to continue, but there are numerous variables that have the potential to impact our volumes. For example, we believe the recent substantial decrease in the price of oil has resulted in reduced demand for our boats in the southwest region due to a loss of jobs. Further, international demand has been diminished by the broad strength of the U.S. dollar where our product prices have increased along with the U.S. dollar, weakening commodity prices in commodity driven economies, and a general weakening in the international economy. The U.S. dollar appreciation and weakening commodity prices is significantly impacting the Canadian market, an important market for us. Demand is also weak in other areas of the world, notably South America, South Africa and Europe. To date, growth in our domestic market has offset significantly diminished demand from international market and in Australia we have continued to benefit in unit and revenue volume from the strengthened U.S. dollar, where demand for Malibu boats versus the imported competition remains in our favor. Because we continue to face international demand challenges and do not expect double digit growth in the U.S. market in the coming year, we limited wholesale shipments of our boats in the fourth quarter of fiscal year 2016, which we believe has resulted in lower dealer inventory levels. We believe these lower inventory levels will allow our wholesale shipments to more closely match retail demand in the near-term. Other challenges that could impact demand for performance sport boats include higher interest rates reducing retail consumer appetite for our product, consumer confidence, the availability of credit to our dealers and retail consumers, fuel costs, the continued acceptance of our new products in the recreational boating market, our ability to compete in the competitive power boating industry, and the costs of labor and certain of our raw materials and key components.

Since 2008, we have increased our market share among manufacturers of performance sport boats due to new product development, improved distribution, redesigned models, and innovative features. As the market for our product has recovered our competitors have become more aggressive in their product introductions, increased their distribution and begun to compete with our patented Surf Gate system. This competitive environment continued in 2015 and our share was up only slightly. However, given recent strong new product introduction and strong retail registration trends, we believe we will increase our domestic market share meaningfully during calendar year 2016. For model year 2016 which began on July 1, 2015, we unveiled the all-new Malibu Wakesetter 25 LSV, the Wakesetter 20 VTX and Axis A20 and in November of 2015 we launched the revolutionary Malibu M235. The M235 was designed to deliver luxury and performance in an ultra-premium market. In addition, on our model year 2016 products, we have further enhanced our Integrated Surf Platform (or "ISP"). Our ISP includes our Surf Gate system and Power Wedge 2 with hydraulic actuators as well as our patented rider controlled Surf Band technology and other key features. Other enhanced features for 2016 include power seats, new windshields, new vinyl and color thread and backup cameras. Also, with model year 2016 we furthered our vertical integration efforts by beginning to manufacture our own trailers. We continue to maintain a strong lead over our nearest competitor in terms of market position and believe that we are well positioned to maintain our industry leading position given our strong dealer network and new product pipeline. In addition, we continue to be the market share leader in both the premium and value-oriented product sub-categories

Factors Affecting Our Results of Operations

We believe that our results of operations and our growth prospects are affected by a number of factors, which we discuss below.

Economic Environment and Consumer Demand

Our product sales are impacted by general economic conditions, which affect the demand for our products, the demand for optional features, the availability of credit for our dealers and retail consumers, and overall consumer confidence. Consumer spending, especially purchases of discretionary items, tends to decline during recessionary periods and tends to increase during expansionary periods. The recreational boating industry was adversely affected by the economic downturn, and is now beginning to recover. In recent years, the performance sport boat category has grown faster than the overall powerboat market. In 2014, domestic sales of new performance sport boats increased by 16% compared to 2013, while new unit sales of all other powerboats grew 6% over the same period. More recently, new unit sales of performance sport boats increased 10% for 2015 compared to the same period in 2014, while new unit sales of all other powerboats increased 7% over the same period. While there is no guarantee that our market will continue to grow, we expect to benefit from the recovery in the boating industry and from improved consumer confidence levels.

New Product Development and Innovation

Our long-term revenue prospects are based in part on our ability to develop new products and technological enhancements that meet the demands of existing and new consumers. Developing and introducing new boat models and features that deliver improved performance and convenience are essential to leveraging the value of our Malibu and Axis brands. By introducing new boat models, we are able to appeal to a new and broader range of consumers and focus on underserved or adjacent segments of the broader powerboat category. We have introduced seventeen new boat models since the beginning of model year 2011. We believe we also are able to capture additional value from the sale of each boat through the introduction of new features, which we believe permits us to raise average selling prices and enhances our margins. We allocate most of our product development costs to new model and feature designs, usually with a specific consumer base and market in mind. We use industry data to analyze our markets and evaluate revenue potential from each major project we undertake. Our product development cycle, or the time from initial concept to volume production, can be up to two years. As a result, our development costs, which may be significant, may not be offset by corresponding new sales during the same periods. Once new designs and technologies become available to our consumers, we typically realize revenue from these products from one year up to 15 years. We may not, however, realize our revenue expectations from each innovation. We believe our close communication with our consumers, dealers and sponsored athletes regarding their future product desires enhances the efficiency of our product development expenditures.

Product Mix

Historically, we have been successful in leveraging our robust product offering and features to enhance our sales growth and gross margins. Our product mix, as it relates to our brands, types of boats and features, not only makes our offerings attractive to consumers but also helps drive higher sales and margins. Typically, we are able to realize higher sales and margins when we sell larger boats compared to our smaller boats, our premium Malibu brand compared to our entry-level Axis brand and our boats that are fully-equipped with optional features. We will strive to continue to develop new features and models and maintain an attractive product mix that optimizes sales growth and margins.

Ability to Manage Manufacturing Costs, Sales Cycles and Inventory Levels

Our results of operations are affected by our ability to manage our manufacturing costs effectively and to respond to changing sales cycles. Our product costs vary based on the costs of supplies and raw materials, as well as labor costs. We have implemented various initiatives to reduce our cost base and improve the efficiency of our manufacturing process. For example, we re-engineered the manufacturing process in our Tennessee facility to reduce labor hours per boat produced and the amount of re-work required. We continuously monitor and review our manufacturing processes to identify improvements and create additional efficiencies. We rely on our insights into the market gleaned from dealer inventory levels, industry reports about anticipated demand for our products in the upcoming sales cycle and

our own estimates and assumptions in formulating our manufacturing plan for the following fiscal year. Throughout our consumer sales cycle, which reaches its peak from March through August each year, we adjust our manufacturing activities in order to adapt to variability in demand.
Dealer Network, Dealer Financing and Incentives

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We rely on our dealer network to distribute and sell our products. We believe we have developed the strongest distribution network in the performance sport boat category. To improve and expand our network and compete effectively for dealers, we regularly monitor and assess the performance of our dealers and evaluate dealer locations and geographic coverage in order to identify potential market opportunities. As a result of management's strategic initiatives, we have sold an increasing number of units to dealers in new territories in the United States and Canada not previously covered prior to 2009. We intend to continue to add dealers in new territories in the United States as well as internationally, which we believe will result in increased unit sales.

Our dealers are exposed to seasonal variations in consumer demand for boats. As discussed above under "Ability to Manage Manufacturing Costs, Sales Cycles and Inventory Levels," we address anticipated demand for our products and manage our manufacturing in order to mitigate seasonal variations. We also use our dealer incentive programs to encourage dealers to order in the off-season by providing floor plan financing relief, which typically permits dealers to take delivery of current model year boats between July 1 and April 30 on an interest-free basis for a specified period. We also offer our dealers other incentives, including rebates, seasonal discounts, promotional co-op arrangements and other allowances. We facilitate floor plan financing programs for many of our dealers by entering into repurchase agreements with certain third-party lenders, which enable our dealers, under certain circumstances, to establish lines of credit with the third-party lenders to purchase inventory. Under these floor plan financing programs, a dealer draws on the floor plan facility upon the purchase of our boats and the lender pays the invoice price of the boats. During fiscal year 2016, we agreed to repurchase three units from the lender of two of our former dealers resulting in combined losses of $0.03 million. Other than these repurchase commitments, we have not repurchased any units from lenders since July 1, 2010. We will continue to review and refine our dealer incentive offerings and monitor any exposures arising under these arrangements.

Vertical Integration

In the fourth quarter of 2015, we completed the construction of our trailer manufacturing facilities and began piloting the production of trailers. Prior to this, we purchased completed trailers from a supplier and shipped them with the boats we sold. On July 1, 2015, we commenced full trailer manufacturing operations and no longer purchase trailers from a third party supplier. We expect this expansion of our business to allow us to reduce or eliminate certain costs, improve the quality of trailers used with our boats and generate various other margin and product opportunities to make us more responsive to our customers' needs and competitive.

Results of Operations

The table below sets forth our consolidated results of operations, expressed in thousands (except unit volume and net sales per unit) and as a percentage of net sales, for the periods presented. Our consolidated financial results for these periods are not necessarily indicative of the consolidated financial results that we will achieve in future periods. Certain totals for the table below will not sum to exactly 100% due to rounding.

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	Fiscal Year Ended June 30,					
	2016		2015		2014	
	$	% Revenue	$	% Revenue	$	% Revenue
Net sales	252,965	100.0 %	228,621	100.0 %	190,935	100.0 %
Cost of sales	186,145	73.6 %	168,192	73.6 %	140,141	73.4 %
Gross profit	66,820	26.4 %	60,429	26.4 %	50,794	26.6 %
Operating expenses:						
Selling and marketing	7,475	3.0 %	7,007	3.1 %	6,098	3.2 %
General and administrative	21,256	8.4 %	19,809	8.7 %	39,974	20.9 %
Amortization	2,185	0.9 %	2,463	1.1 %	5,177	2.7 %
Operating income (loss)	35,904	14.2 %	31,150	13.6 %	(455)	(0.2)%
Other income (expense):						
Other	76	— %	1,650	0.7 %	9	— %
Interest expense	(3,884)	(1.5)%	(954)	(0.4)%	(2,962)	(1.6)%
Other income (expense), net	(3,808)	(1.5)%	696	0.3 %	(2,953)	(1.5)%
Net income (loss) before provision (benefit) for income taxes	32,096	12.7 %	31,846	13.9 %	(3,408)	(1.8)%
Income tax provision (benefit)	11,801	4.7 %	8,663	3.8 %	(2,220)	(1.2)%
Net income (loss)	20,295	8.0 %	23,183	10.1 %	(1,188)	(0.6)%
Net income attributable to non-controlling interest	2,253	0.9 %	8,522	3.7 %	3,488	1.8 %
Net income (loss) attributable to Malibu Boats, Inc.	18,042	7.1 %	14,661	6.4 %	(4,676)	(2.4)%

	Fiscal Year Ended June 30,					
	2016		2015		2014	
	Unit Volumes	% Total	Unit Volumes	% Total	Unit Volumes	% Total
Volume by Segment						
US	3,255	91.2 %	3,179	93.4 %	2,910	100.0 %
Australia	314	8.8 %	225	6.6 %	—	— %
Total Units	3,569		3,404		2,910	
Volume by Brand						
Malibu	2,388	66.9 %	2,325	68.3 %	2,110	72.5 %
Axis	1,181	33.1 %	1,079	31.7 %	800	27.5 %
Total Units	3,569		3,404		2,910	
Net sales per unit	$70,878		$67,162		$65,613	

Comparison of the Fiscal Year Ended June 30, 2016 to the Fiscal Year Ended June 30, 2015

Net Sales

Net sales for fiscal year 2016 increased $24.3 million, or 10.6%, to $253.0 million, compared to fiscal year 2015. Included in net sales for fiscal years 2016 and 2015 were net sales of $20.8 million and $14.9 million, respectively, attributable to our Australian operations acquired in October 2014. Unit volume for fiscal year 2016 increased 165 units, or 4.8%, to 3,569 units compared to fiscal year 2015. Of the 165 units added, 89 units were added as a result of our Australian business and the remainder of the increase was primarily due to a demand-driven increase in our daily production rate over the prior year, bolstered by the strong demand for new, larger models such as the M235 and 25 LSV, offset by currency-driven challenges in international markets outside of Australia, including Canada. Net sales per unit for fiscal year 2016 increased approximately 5.5% to $70,878 compared to fiscal year 2015, primarily driven by year over year price increases and our increased mix of larger model sales, which carry a higher average selling price, and increased demand for optional features and trailers, partially offset by our Australian operations, which carry a lower average selling price per unit. Net sales per unit for our U.S. segment, which includes our international business other than Australia, increased approximately 6.8% to $73,637 for fiscal year 2016 as compared to fiscal year 2015. The increase was primarily driven by higher prices on new model year product, the increased mix of larger model sales, and increased demand for optional features and trailers, partially offset by increased discount activity on, among others, international sales to offset the impact of negative foreign currency fluctuations on sales prices attributable to a strengthened U.S. dollar and increased sales of our Axis brand which carry a lower average selling price than our Malibu brand.

Cost of Sales

Cost of sales for fiscal year 2016 increased $18.0 million, or 10.7%, to $186.1 million compared to fiscal year 2015. The increase in cost of sales was due primarily to increased volumes driven by higher throughput at our U.S. operations and the addition of our Australian business in the second quarter of fiscal year 2015. Cost of sales per unit for our U.S. operations on a stand alone basis increased approximately 6.9% for fiscal year 2016 compared to fiscal year 2015 driven by the mix of larger model sales, which have higher material content and labor hours, and the extension of our warranty period of coverage from three to five years for model year 2016, offset by lower trailer cost per unit created from manufacturing efficiencies.

Gross Profit

Gross profit for fiscal year 2016 increased $6.4 million, or 10.6%, compared to fiscal year 2015. The increase in gross profit resulted primarily from higher volumes. Gross margin for fiscal year 2016 was unchanged at 26.4% compared to fiscal year 2015 as gains associated with our mix of larger model sales, demand-driven increase in optional features and trailers, higher prices on new model year products and production efficiencies around trailer manufacturing, were offset by increased discount activity particularly in international markets due to the impact of a strengthened U.S. dollar on sales prices, and the impact of inclusion of our Australian business where margins have been under pressure from the strength of the U.S. dollar.

Operating Expenses

Selling and marketing expense for fiscal year 2016 increased $0.5 million, or 6.7%, to $7.5 million compared to fiscal year 2015 primarily due to increased event sponsorship. General and administrative expense for fiscal year 2016 increased $1.4 million, or 7.3%, to $21.3 million compared to fiscal year 2015 largely due to a $3.3 million charge related to a judgment rendered against us in the Marine Power Holding, LLC ("Marine Power) litigation (see Note 16 to our consolidated financial statements included elsewhere in this Annual Report), higher payroll related expenses attributed to higher headcount, stock compensation costs, and operating expenses attributable to a full year of activity at our Australian operations, offset by decreases in offering and acquisition related costs. Amortization expense for fiscal year 2016 decreased $0.3 million, or 11.3%, to $2.2 million primarily due to the full amortization in the first quarter of fiscal year 2015 of our dealer relationship intangible acquired in 2006, offset by amortization attributable to intangible assets acquired in the acquisition of our Australian licensee in October 2014.

Other Income (Expense), Net

Other expense, net for the fiscal year 2016 increased $4.5 million to $3.8 million compared to fiscal year 2015. The increase in other expense, net was primarily due to a decrease in other income related to the settlement of our patent infringement lawsuit with Nautique in February 2015 and an increase in interest expense associated with our $80.0 million term loan entered into in April 2015, which resulted in higher average outstanding debt for fiscal year 2016 than for fiscal year 2015. The balance of the increase in other expense, net is attributable to an increase in interest expense related to the change in the fair value of our interest rate swap we entered into on July 1, 2015.

Income Taxes

Our provision for income taxes for fiscal year 2016 increased $3.1 million, to $11.8 million compared to fiscal year 2015. The increase in our provision for income taxes reflects an increase in our effective tax rate which was 36.8% for fiscal year 2016 compared to 27.2% for fiscal year 2015. The reported effective tax rates differs from the statutory federal income tax rate of 35% primarily due to the impact of the non-controlling interest, state income taxes attributable to the LLC, and the benefit of deductions under Section 199 of the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). Additionally, our effective tax rates also reflect the impact of our share of the LLC's permanent items such as stock-based compensation expense attributable to profits interests. We note that in fiscal year 2015, our effective tax rate was impacted by nondeductible offering costs, acquisition related costs, and the impact of an out-of-period tax adjustment associated with benefits recognized for the Tennessee jobs tax credit that are not expected to be recurring in nature.

Non-controlling interest

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Non-controlling interest represents the ownership interests of the members of the LLC other than us and the amount recorded as non-controlling interest in our consolidated statements of operations and comprehensive income (loss) is computed by multiplying pre-tax income for fiscal year 2016 by the percentage ownership in the LLC not directly attributable to us. For fiscal years 2016 and 2015, the weighted average non-controlling interest attributable to ownership interests in the LLC not directly attributable to us was 11.1% and 36.8%, respectively.

Comparison of the Fiscal Year Ended June 30, 2015 to the Fiscal Year Ended June 30, 2014

Net Sales

Net sales for fiscal year 2015 increased $37.7 million, or 19.7%, to $228.6 million, compared to fiscal year 2014. Included in net sales for fiscal year 2015 were net sales of $14.9 million attributable to our Australian operations that we acquired in October 2014. Unit volume for fiscal year 2015 increased 494 units, or 17.0%, to 3,404 units compared to fiscal year 2014. Of the 494 units added, 225 were added as a result of our Australian operations and the remainder of the increase was primarily due to a demand-driven increase in our daily production rate over the prior year, bolstered by the introduction of four new models; two each for Malibu and Axis, and our innovative features. Net sales per unit increased approximately 2.4% to $67,162 for fiscal year 2015 compared to fiscal year 2014, primarily driven by higher prices in our U.S. operations and increased selection of optional features, partially offset by the elimination of parts sales between our segments since the acquisition of our Australian licensee in October 2014 and increased sales of our Axis brand. Net sales per unit for our U.S. operations increased approximately 5.1% for fiscal year 2015 compared to fiscal year 2014.

Cost of Sales

Cost of sales for fiscal year 2015 increased $28.1 million, or 20.0% to $168.2 million compared to fiscal year 2014. Included in cost of sales was $0.9 million of integration related expenses attributable to the acquisition of our Australian licensee. The increase in cost of sales resulted primarily from the 17.0% increase in unit volume and higher material cost per unit, driven primarily by higher material content per unit associated with the addition of new features such as our new Malibu dash for model year 2015 and increased optional feature selections such as the G4 tower in addition to integration related expenses for our Australian acquisition.

Gross Profit

Gross profit for fiscal year 2015 increased $9.6 million, or 19.0%, to $60.4 million compared to the same period during 2014. The increase in gross profit resulted primarily from higher volumes. Gross margin decreased 0.2% to 26.4% for fiscal year 2015 compared to the same period in 2014. The decrease in gross margin resulted primarily from $0.9 million of integration related expenses attributable to the acquisition of our Australian licensee. Excluding these integration related expenses, gross margin increased to 26.8%, or 20 basis points, for fiscal year 2015 and was driven by a year over year increase of 48 basis points in our U.S. operations.

Operating Expenses

Selling and marketing expense increased $0.9 million, or 14.9%, to $7.0 million for fiscal year 2015 compared to fiscal year 2014 primarily due to increased volumes, as well as incremental selling and marketing related expenses in Australia. General and administrative expense decreased $20.2 million, or 50.4%, to $19.8 million for fiscal year 2015 compared to fiscal year 2014. The decrease in general and administrative expenses is largely attributable to a fiscal year 2014 one-time charge of $20.0 million related to the settlement of litigation with Pacific Coast Marine Windshields Ltd., or PCMW. General and administrative expenses, excluding the impact of the settlement, decreased 0.8% or $0.2 million primarily driven by a $4.6 million decrease in expenses related to the LLC's former management agreement terminated in connection with our IPO on February 5, 2014, a $1.1 million decrease in stock compensation expense which included a $1.8 million charge in the fourth quarter of 2014 for the modification of awards granted in 2012, and a decrease of $1.4 million in offering related expenses attributed to our equity offerings in fiscal years 2014 and 2015. The decrease in general and administrative expenses was offset by an increase in litigation related professional fees of $2.1 million, $0.8 million in transaction expenses related to our Australia acquisition, $0.8 million of expenses related to our Australia operations, as well as increased expenses related to being a public company for a full year and modest traditional expense growth. Amortization expense for fiscal year 2015 decreased $2.7 million, or 52.4%, to $2.5 million primarily due to the full amortization in the first quarter of fiscal year 2015 of our dealer relationship intangible acquired in 2006, offset by amortization attributable to intangible assets acquired in the acquisition of our Australian licensee in October 2014.

Other Income (Expense), Net

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Other income increased $3.6 million for fiscal year 2015 to $0.7 million as compared to other expense of $3.0 million for fiscal year 2014. The increase in other income is primarily related to our settlement of our patent infringement lawsuit with Nautique. Under terms of the Nautique Settlement Agreement entered into on February 6, 2015 (the “Nautique Settlement Agreement”), we received $2.3 million, which was attributed to the settlement of patent infringement claims and future royalty payments under a royalty-bearing licensing agreement we entered with Nautique for boats sold by Nautique with our surfing technology beginning on February 1, 2015. Our interest expense also decreased by $2.0 million from fiscal year 2014 to fiscal year 2015 because of a lower weighted average of outstanding debt during fiscal year 2015. We repaid our $65.0 million term loan with the proceeds from our IPO in February 2014. In April 2015, we incurred an $80.0 million term loan and used the proceeds for the purchase price of our Tender Offer and to repay approximately $10.0 million outstanding under our revolving credit facility.

Income Taxes

Provision for income taxes was $8.7 million for the fiscal year ended June 30, 2015 and a benefit of $2.2 million for the fiscal year ended June 30, 2014, reflecting a reported effective tax rate of 27.2% and 65.2%, respectively. The reported effective tax rate differs from the statutory federal income tax rate of 35% primarily due to the impact of the non-controlling interest and state income taxes attributable to the LLC on our share of the LLC's income (loss), including the impact of an out-of-period tax adjustment of $0.8 million primarily associated with benefits recognized for the Tennessee jobs tax credit. In addition, the reported effective tax rate was impacted by our share of the LLC's permanent items such as stock compensation expense attributable to profits interests and nondeductible offering costs for fiscal years 2015 and 2014 and acquisition related costs for fiscal year 2015. There was no provision for income taxes prior to our IPO on February 5, 2014 because the LLC was a pass-through entity for federal purposes and, therefore, was not subject to federal income taxes.

Non-controlling interest

Non-controlling interest represents the ownership interests of the members of the LLC other than us and the amount recorded as non-controlling interest in our consolidated statements of operations and comprehensive income (loss) is computed by multiplying pre-tax income (loss) for the period by the percentage ownership in the LLC not directly attributable to us. For the fiscal year ended June 30, 2015, the weighted average non-controlling interest attributable to ownership interests in the LLC not directly attributable to us was 36.8%. All of the pre-tax income (loss) for the period up to our IPO on February 5, 2014 was attributed to the non-controlling interest. Following the IPO through June 30, 2014, the non-controlling interest was 50.7%.

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GAAP Reconciliation of Non-GAAP Financial Measures

Adjusted EBITDA

Adjusted EBITDA and adjusted EBITDA margin are non-GAAP financial measures that are used by management as well as by investors, commercial bankers, industry analysts and other users of our financial statements.

We define adjusted EBITDA as net income (loss) before interest expense, income taxes, depreciation, amortization and non-cash, non-recurring or non-operating expenses, including management fees and expenses, certain professional fees, litigation related expenses, acquisition and integration related expenses, non-cash compensation expense, and offering related expenses. We define adjusted EBITDA margin as adjusted EBITDA divided by net sales. Adjusted EBITDA and adjusted EBITDA margin are not measures of net income (loss) as determined by GAAP. Management believes adjusted EBITDA and adjusted EBITDA margin are useful because they allow management to evaluate our operating performance and compare the results of our operations from period to period and against our peers without regard to our financing methods, capital structure and non-recurring or non-operating expenses. We exclude the items listed above from net income (loss) in arriving at adjusted EBITDA because these amounts can vary substantially from company to company within our industry depending upon accounting methods and book values of assets, capital structures, the methods by which assets were acquired and other factors. Adjusted EBITDA has limitations as an analytical tool and should not be considered as an alternative to, or more meaningful than, net income (loss) as determined in accordance with GAAP or as an indicator of our liquidity. Certain items excluded from adjusted EBITDA are significant components in understanding and assessing a company's financial performance, such as a company's cost of capital and tax structure, as well as the historical costs of depreciable assets. Our presentation of adjusted EBITDA and adjusted EBITDA margin should not be construed as an inference that our results will be unaffected by unusual or non-recurring items. Our computations of adjusted EBITDA and adjusted EBITDA margin may not be comparable to other similarly titled measures of other companies.

The following table sets forth a reconciliation of net income (loss) as determined in accordance with GAAP to adjusted EBITDA and adjusted EBITDA margin for the periods indicated (dollars in thousands):

	Fiscal Year Ended June 30,		
	2016	2015	2014
Net income (loss)	$20,295	$23,183	$(1,188)
Income tax provision (benefit)	11,801	8,663	(2,220)
Interest expense	3,884	954	2,962
Depreciation	3,339	2,427	1,600
Amortization	2,185	2,463	5,177
Management fees and expenses [1]	—	—	4,584
Professional fees and Nautique litigation settlement [2]	1,111	2,654	2,219
PCMW litigation settlement [3]	—	—	20,000
Marine Power litigation judgment [4]	3,268	—	—
Acquisition and integration related expenses [5]	401	1,676	—
Stock-based compensation expense [6]	1,947	1,467	2,577
Offering related expenses [7]	—	161	1,561
Adjusted EBITDA	$48,231	$43,648	$37,272
Adjusted EBITDA margin	19.1 %	19.1 %	19.5 %

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(1) Represents management fees and out-of-pocket expenses paid pursuant to our management agreement with Malibu Boats Investor, LLC, an affiliate, which was terminated upon the closing of the IPO. Upon termination of the agreement, we paid a one-time termination fee of $3.75 million.

(2) Represents legal and advisory fees related to our refinancing activities and legal expenses associated with our litigation with PCMW and Nautique, offset by the portion of the $2.3 million settlement received from Nautique for past infringement claims under the Nautique Settlement Agreement entered into on February 6, 2015. For more information about legal proceedings, refer to Note 16 of our consolidated financial statements included elsewhere in this Annual Report.

(3) Represents a one-time charge related to the settlement of litigation with PCMW on September 15, 2014. For more information, see Note 16 to our consolidated financial statements included elsewhere in this Annual Report.

(4) Represents a one-time charge related to a judgment rendered against us in connection with a lawsuit by Marine Power, a former engine supplier, on August 18, 2016. For more information, see Note 16 to our consolidated financial statements included elsewhere in this Annual Report.

(5) Represents legal and advisory fees as well as integration related costs incurred in connection with acquisition activities, including our acquisition of Malibu Boats Pty. Ltd. completed on October 23, 2014.

(6) Represents equity-based incentives awarded to certain of our employees under the Malibu Boats, Inc. Long-Term Incentive Plan and profit interests issued under the previously existing limited liability company agreement of the LLC. During the second quarter of fiscal year 2014, we recorded a $1.8 million stock compensation charge as a result of the modification of certain profits interest awards previously granted in 2012 under the first amended and restated limited liability company agreement of the LLC, as amended, in connection with our IPO. See Note 14 to our consolidated financial statements included elsewhere in this Annual Report.

(7) Includes legal and advisory costs incurred in connection with our equity offerings, equity tender offer and IPO completed in fiscal years 2015 and 2014, respectively. There were no such offerings for fiscal year 2016.

Adjusted Fully Distributed Net Income

We define Adjusted Fully Distributed Net Income as net income (loss) attributable to Malibu (i) excluding income tax expense (benefit), (ii) excluding the effect of non-recurring or non-cash items, (iii) assuming the exchange of all units in the LLC ("LLC Units") into shares of Class A Common Stock, which results in the elimination of non-controlling interest in the LLC, and (iv) reflecting an adjustment for income tax expense on fully distributed net income (loss) before income taxes (assuming no income attributable to non-controlling interests) at our estimated effective income tax rate. Adjusted Fully Distributed Net Income is a non-GAAP financial measure because it represents net income (loss) attributable to Malibu Boats, Inc., before non-recurring or non-cash items and the effects of non-controlling interests in the LLC.

We use Adjusted Fully Distributed Net Income to facilitate a comparison of our operating performance on a consistent basis from period to period that, when viewed in combination with our results prepared in accordance with GAAP, provides a more complete understanding of factors and trends affecting our business than GAAP measures alone.

We believe Adjusted Fully Distributed Net Income assists our board of directors, management and investors in comparing our net income (loss) on a consistent basis from period to period because it removes non-cash or non-recurring items, and eliminates the variability of non-controlling interest as a result of member owner exchanges of LLC Units into shares of Class A Common Stock.

In addition, because Adjusted Fully Distributed Net Income is susceptible to varying calculations, the Adjusted Fully Distributed Net Income measures, as presented in this Annual Report, may differ from and may, therefore, not be comparable to similarly titled measures used by other companies.

The table that follows shows the reconciliation of net income (loss) attributable to Malibu Boats, Inc. to Adjusted Fully Distributed Net Income for the periods presented (in thousands except per share data):

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	Fiscal Year Ended June 30,		
	2016	2015	2014
Net income (loss) attributable to Malibu Boats, Inc.	$18,042	$ 14,661	$ (4,676)
Income tax provision (benefit)	11,801	8,663	(2,220)
Management fees and expenses [1]	—	—	4,584
Professional fees and Nautique litigation settlement [2]	1,111	2,654	2,219
PCMW litigation settlement [3]	—	—	20,000
Marine Power litigation judgment [4]	3,268	—	—
Acquisition and integration related expenses [5]	401	1,676	—
Fair value adjustment for interest rate swap [6]	863	—	—
Stock-based compensation expense [7]	1,947	1,467	2,577
Offering related expenses [8]	—	161	1,561
Net income attributable to non-controlling interest [9]	2,253	8,522	3,488
Fully distributed net income before income taxes	39,686	37,804	27,533
Income tax expense on fully distributed income before income taxes [10]	14,089	13,420	9,912
Adjusted Fully Distributed Net Income	$25,597	$ 24,384	$ 17,621
Adjusted Fully Distributed Net Income per share of Class A Common Stock [11]:			
Basic	$1.32	$ 1.11	$ 0.78
Diluted	$1.32	$ 1.11	$ 0.78
Shares of Class A Common Stock outstanding used in computing Adjusted Fully Distributed Net Income [12]:			
Basic	19,390,357	21,926,801	22,498,631
Diluted	19,390,357	21,926,801	22,498,631

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(1) Represents management fees and out-of-pocket expenses paid pursuant to our management agreement with Malibu Boats Investor, LLC, an affiliate, which was terminated upon the closing of the IPO. Upon termination of the agreement, we paid a one-time termination fee of $3.75 million.

(2) Represents legal and advisory fees related to our refinancing activities and legal expenses associated with our litigation with PCMW and Nautique, offset by the portion of the $2.3 million settlement received from Nautique for past infringement claims under the Nautique Settlement Agreement entered into on February 6, 2015. For more information about legal proceedings, refer to Note 16 of our consolidated financial statements included elsewhere in this Annual Report.

(3) Represents a one-time charge related to the settlement of litigation with PCMW on September 15, 2014. For more information, see Note 16 to our consolidated financial statements included elsewhere in this Annual Report.

(4) Represents a one-time charge related to a judgment rendered against us in connection with a lawsuit by Marine Power, a former engine supplier, on August 18, 2016. For more information, see Note 16 to our consolidated financial statements included elsewhere in this Annual Report.

(5) Represents legal and advisory fees as well as integration related costs incurred in connection with acquisition activities, including our acquisition of Malibu Boats Pty. Ltd. completed on October 23, 2014.

(6) Represents the change in the fair value of our interest rate swap entered into on July 1, 2015.

(7) Represents equity-based incentives awarded to certain of our employees under the Malibu Boats, Inc. Long-Term Incentive Plan and profit interests issued under the previously existing limited liability company agreement of the LLC. During the second quarter of fiscal year 2014, we recorded a $1.8 million stock compensation charge as a result of the modification of certain profits interest awards previously granted in 2012 under the first amended and restated limited liability company agreement of the LLC, as amended, in connection with our IPO. See Note 14 to our audited consolidated financial statements included elsewhere in this Annual Report.

(8) Includes legal and advisory costs incurred in connection with our equity offerings, equity tender offer and IPO completed in fiscal years 2015 and 2014, respectively. There were no such offerings for fiscal year 2016.

(9) Reflects the elimination of the non-controlling interest in the LLC as if all LLC members had fully exchanged their LLC Units for shares of Class A Common Stock. Earnings (loss) prior and up to our IPO on February 5, 2014 were entirely allocable to members of the LLC, as such we updated our historical presentation to attribute these earnings (loss) to the non-controlling interest LLC Unit holders.

(10) Reflects income tax expense at an estimated normalized annual effective income tax rate of 35.5% for fiscal year 2016 and 2015, respectively, and 36.0% of income (loss) before income taxes for the fiscal year 2014, assuming the conversion of all LLC Units into shares of Class A Common Stock and the tax impact of excluding offering related expenses. The estimated normalized annual effective income tax rate is based on the federal statutory rate plus a blended state rate adjusted for deductions under Section 199 of the Internal Revenue Code of 1986, as amended, and foreign income taxes attributable to our Australian based subsidiary.

(11) Adjusted fully distributed net income divided by the shares of Class A Common Stock outstanding in (12) below.

(12) Represents the weighted average shares outstanding during the applicable period calculated as (i) the weighted average shares outstanding during the applicable period of Class A Common Stock, (ii) the weighted average shares outstanding of LLC Units held by non-controlling interests assuming they were exchanged into Class A Common Stock on a one-for-one basis and (iii) the weighted average fully vested restricted stock units outstanding during the applicable period that were convertible into Class A Common Stock and granted to directors for their services.

Quarterly Results of Operations

The table below sets forth our unaudited quarterly consolidated statements of operations and comprehensive income (loss) data for each of the eight quarters through the period ended June 30, 2016. The unaudited quarterly consolidated statements of operations and comprehensive income (loss) data were prepared on a basis consistent with the audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. In the opinion of management, the quarterly financial information reflects all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of this data. This information should be read in conjunction with the audited consolidated financial statements and related notes included elsewhere in this Annual Report. The historical results presented below are not necessarily indicative of the results to be expected for any future period, and the results for any interim period may not necessarily be indicative of the results of operations for a full year. The numbers in this table may not foot due to rounding differences.

	Three Months Ended (Unaudited)							
	June 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	June 30, 2015	Mar. 31, 2015	Dec. 31, 2014	Sept. 30, 2014
Net sales	$66,680	$68,539	$60,506	$57,240	$60,716	$64,762	$55,484	$47,659
Gross profit	17,825	18,406	15,879	14,710	16,275	17,897	14,164	12,093
Operating income	7,825	11,825	8,979	7,275	11,324	9,523	6,998	3,305
Net income	4,090	6,507	5,718	3,980	7,575	7,643	5,576	2,389
Net income attributable to non-controlling interest	486	731	614	422	1,923	3,278	2,312	1,009
Net income attributable to Malibu Boats, Inc.	$3,604	$5,776	$5,104	$3,558	$5,652	$4,365	$3,264	$1,380

Liquidity and Capital Resources

Our primary sources of funds are cash provided by operating activities and borrowings under our revolving credit facility. Our primary use of funds has been for capital investments, debt repayments, repurchase of common stock and cash distributions to members of the LLC. The following table summarizes the cash flows from operating, investing and financing activities (dollars in thousands):

	Fiscal Year Ended June 30,		
	2016	2015	2014
Total cash provided by (used in):			
Operating activities	$35,602	$12,552	$23,765
Investment activities	(5,990)	(17,129)	(5,906)
Financing activities	(12,022)	742	(21,643)
Impact of currency exchange rates on cash balances	(56)	49	—
Increase (decrease) in cash	$17,534	$(3,786)	$(3,784)

Comparison of the Fiscal Year Ended June 30, 2016 to the Fiscal Year Ended June 30, 2015

Operating Activities

Net cash from operating activities was $35.6 million for fiscal year 2016, compared to $12.6 million for the same period in 2015, an increase of $23.0 million. The increase in cash provided from operating activities was primarily due to our one-time payment of $20.0 million in fiscal year 2015 to settle the PCMW litigation. Excluding the settlement payment, cash flows from operating activities increased $3.0 million in fiscal year 2016 compared to fiscal year 2015, mostly due to changes in working capital offset by payments of $2.8 million under our tax receivable agreement. The increase in working capital was primarily due to a decrease in net cash used of $7.5 million related to payments made for accounts payable and a decrease in cash used related to inventory purchases of $2.9 million, offset by a decrease of $3.0 million in cash collections on accounts receivable and increased payments of income taxes.

Investing Activities

Net cash used for investing activities was $6.0 million for fiscal year 2016 compared to $17.1 million for the same period in 2015, a decrease of $11.1 million. The decrease in cash used in investing activities was primarily related to the acquisition of our Australian licensee which occurred in fiscal year 2015, offset by an increase in capital outlays for property, plant, and equipment which include boat molds, expansion of our trailer manufacturing infrastructure, and a mezzanine addition in the main facility at our Loudon, Tennessee plant in fiscal year 2016.

Financing Activities

Net cash used in financing activities was $12.0 million for fiscal year 2016 compared to net cash provided from financing activities of $0.7 million for fiscal year 2015, a decrease in cash of $12.7 million. During fiscal year 2016, we made principal payments on our outstanding term loan of $6.5 million, paid distributions to LLC unit holders of $1.4 million and repurchased $4.0 million of our Class A Common Stock under a share repurchase program. During fiscal year 2015, we utilized $20.0 million under our revolving credit facility to fund the PCMW settlement agreement and acquisition of our Australian licensee. During this same period, we paid distributions to LLC unit holders of $3.6 million and completed two equity offerings, including a follow-on and secondary, for which we received net proceeds of $133.0 million and used those proceeds to purchase LLC Units directly from existing holders of LLC Units. In addition, we consummated an equity tender offer using proceeds of $80.0 million from our term loan entered into on April 2, 2015 to repurchase our Class A Common Stock. In connection with these equity offerings and the equity tender offer, we paid $1.5 million in legal and advisory costs upon their completion. There were no such offerings during fiscal year 2016.

Comparison of the Fiscal Year Ended June 30, 2015 to the Fiscal Year Ended June 30, 2014

Operating Activities

Net cash from operating activities was $12.6 million for fiscal year 2015, compared to $23.8 million for the same period in 2014, a decrease of $11.2 million. The decrease in cash from operating activities was primarily due to cash payments of approximately $21.3 million, including a $20.0 million payment to settle our PCMW litigation in October

2014 and legal fees

associated with our litigation matters, acquisition related costs paid in connection with the acquisition of our Australian licensee and incremental costs associated with being a public company. Cash receipts from boat sales to our dealer network increased $34.4 million during fiscal year 2015 as compared to fiscal year 2014, driven mostly by higher unit sales volume, which increased 17.0% and higher average net sales per unit, which increased 2.4% over the same period. The higher average net sales per unit was attributable to higher sales prices in our U.S. segment and increased selection of optional features. Cash payments to suppliers for purchase of raw material and other supplies used in the manufacturing process increased $24.3 million for fiscal year 2015, compared to the same period in 2014, primarily due to increased production levels associated with the higher volumes as well as increased material cost per unit, driven primarily by higher material content per unit associated with the addition of new features such as our new Malibu dash for model year 2015 and increased optional features including the G4 tower. Cash paid for interest decreased $0.9 million due to the pay down of the amounts owed under our credit facilities and term loans with proceeds from the IPO completed February 5, 2014.

Investing Activities

Net cash used for investing activities was $17.1 million for fiscal year 2015 compared to $5.9 million for the same period in 2014, an increase of $11.2 million. Our cash used for investing activities for fiscal year 2015 included the acquisition of our Australian licensee as well as investments in new property and equipment, including boat molds, a mezzanine and production area additions to our main facility, and construction of a warehouse and loading facility as well as capital outlays for trailer manufacturing infrastructure at our Loudon, Tennessee plant.

Financing Activities

Net cash provided by financing activities was $0.7 million for fiscal year 2015 compared to net cash used of $21.6 million for fiscal year 2014, an increase of $22.3 million. During fiscal year 2015, we borrowed $80.0 million in term debt to fund our Tender Offer and repaid approximately $10.0 million outstanding under our prior revolving credit facility. We also received proceeds of $20.0 million under our prior revolving credit facility to fund the PCMW settlement and the acquisition of our Australian licensee. For this same period, we incurred $1.2 million in financing fees. Further, during fiscal year 2015, we completed follow-on equity offerings in July 2014 and May 2015. We used all the proceeds from the July 2014 offering to purchase LLC Units directly from existing holders of LLC Units. We did not receive any proceeds from the May 2015 offering, because all of the shares sold in the offering were by our existing holders. We paid costs of $1.5 million which were directly attributable to the completion of the follow-on offerings. Distributions paid to LLC unit holders for fiscal year 2015 were $3.6 million.

Loans and Commitments

Our indirect subsidiary, Malibu Boats, LLC, as borrower (the "Borrower"), has lending arrangements with several financial institutions pursuant to a credit agreement with a syndicate of banks led by SunTrust Bank (the "Amended and Restated Credit Agreement"). Borrowings under the Amended and Restated Credit Agreement bear interest at a rate equal to either, at our option, (i) the highest of the prime rate, the Federal Funds Rate plus 0.5% or one-month London Interbank Offered Rate ("LIBOR") plus 1% (the "Base Rate") or (ii) LIBOR, in each case plus an applicable margin ranging from 1.00% to 1.75% with respect to Base Rate borrowings and 2.00% to 2.75% with respect to LIBOR borrowings. The applicable margin will be based upon the consolidated leverage ratio of the LLC and its subsidiaries calculated on a consolidated basis. Malibu Boats, LLC will also be required to pay a commitment fee for the unused portion of the revolving credit facility, which will range from 0.25% to 0.40% per annum, depending on the LLC’s and its subsidiaries’ consolidated leverage ratio. Malibu Boats, Inc. is not a party to the Amended and Restated Credit Agreement. The obligations of the Borrower under the credit agreement are guaranteed by its parent, the LLC, and, subject to certain exceptions, the present and future domestic subsidiaries of the Borrower, including Malibu Boats Domestic International Sales Corp. and Malibu Australian Acquisition Corp., and all such obligations are secured by substantially all of the assets of the LLC, the Borrower and such subsidiary guarantors pursuant to a security agreement, by and among the Borrower, the LLC, the subsidiary guarantors, and SunTrust Bank, as administrative agent, dated April 2, 2015 (the “Security Agreement”), and other collateral documents. As of June 30, 2016, the Amended and Restated Credit Agreement included the following facilities:

- Revolving Credit Facility. Malibu Boats, LLC has access to a revolving credit facility from a bank syndicate led by SunTrust Bank with available borrowings of $25.0 million due on or before April 2, 2020. As of June 30, 2016, no amounts were outstanding under the revolving credit facility.

- Swingline Credit Facility. Malibu Boats, LLC received a swingline line of credit from SunTrust Bank in the principal amount of up to $5.0 million due on or before April 2, 2020. Any amounts drawn under the swingline line of credit reduce the capacity under the revolving credit facility. As of June 30, 2016, no amounts were outstanding under the swingline facility.

- Letter of Credit Facility. Malibu Boats, LLC has the ability to request the issuance of letters of credit by SunTrust Bank in the principal amount of up to $5.0 million. The principal amounts of any issued but undrawn letters of credit and any amounts drawn under issued letters of credit that have not been reimbursed reduce the availability under the revolving credit facility. As of June 30, 2016, $0.1 million was issued and undrawn under the letter of credit facility.
- Term Loans. Malibu Boats, LLC received a term loan from each of the banks in the syndicate in the aggregate principal amount of $80.0 million due on or before April 2, 2020. As of June 30, 2016, we had a total of $72.0 million outstanding under the term loans.

Subject to the terms of the credit agreement, Malibu Boats, LLC has the option to request the lenders to increase the aggregate amount under the revolving credit facility and the term loan facility up to an additional $50.0 million; however, the lenders are not obligated to do so.

The Amended and Restated Credit Agreement permits prepayment of the new term loan facility without any penalties. The term loan facility under the Amended and Restated Credit Agreement was subject to quarterly installments of $1.5 million per quarter until March 31, 2016. The quarterly installments are now $2.0 million per quarter until March 31, 2019, and $2.5 million per quarter thereafter. The Amended and Restated Credit Agreement also requires prepayments from the net cash proceeds received by the Borrower or any guarantors from certain asset sales and recovery events, subject to certain reinvestment rights, and from excess cash flow, subject to the terms and conditions of the Amended and Restated Credit Agreement.

The Amended and Restated Credit Agreement contains certain customary representations and warranties, and notice requirements for the occurrence of specific events such as the occurrence of any event of default, or pending or threatened litigation. The Amended and Restated Credit Agreement also requires compliance with certain customary financial covenants, including a minimum ratio of EBITDA to fixed charges and a maximum ratio of total debt to EBITDA. The Amended and Restated Credit Agreement contains certain restrictive covenants, which, among other things, place limits on certain activities of the loan parties under the Amended and Restated Credit Agreement, such as the incurrence of additional indebtedness and additional liens on property and limits the future payment of dividends or distributions. For example, the Amended and Restated Credit Agreement generally prohibits the LLC, the Borrower and the subsidiary guarantors from paying dividends or making distributions, including to the Company. The Amended and Restated Credit Agreement permits, however, distributions based on a member’s allocated taxable income, distributions to fund payments that are required under the tax receivable agreement, payments pursuant to stock option and other benefit plans up to $2.0 million in any fiscal year, dividends and distributions within the loan parties and dividends payable solely in interests of classes of securities. In addition, the LLC may make dividends and distributions of up to $6.0 million in any fiscal year and dividends and distributions up to $15.0 million in connection with our Repurchase Program, in each case, subject to compliance with other financial covenants. The credit agreement specifies permitted liens, permitted investments and permitted debt. Affirmative covenants governing the timing of monthly, quarterly and annual financial reporting are also included in the credit agreement.

Future Liquidity Needs

Management believes that our existing cash, borrowing capacity under our revolving credit facility and cash flows from operations will be sufficient to fund our operations for the next 12 months. Our future capital requirements will depend on many factors, including the general economic environment in which we operate and our ability to generate cash flow from operations. Factors impacting our cash flow from operations include, but are not limited to, our growth rate and the timing and extent of operating expenses.

We estimate that approximately $4.2 million and $8.0 million will be due under the tax receivable agreement and our term loan, respectively, within the next 12 months. In accordance with the tax receivable agreement, the next payment is anticipated to occur approximately 75 days after filing the federal tax return which is due on March 15, 2017. Management expects minimal effect on our future liquidity and capital resources.

Capital Resources

Management expects our capital expenditures for fiscal year 2017 to be significantly higher than our 2016 capital expenditures primarily driven by expected investment in an adjacent facility that we plan to use to reduce existing leases or for vertical integration initiatives. In addition, capital expenditures for fiscal year 2017 are expected to consist primarily of the finishing of our ongoing projects, new tooling, and expenditures to increase production capacity to accommodate future growth.

Stock Repurchase Program

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On February 1, 2016, our board of directors authorized a stock repurchase program to allow for the repurchase of up to $15.0 million of our Class A Common Stock and the LLC's LLC Units for the period from February 8, 2016 to February 8, 2017. Upon repurchase, the shares are classified as treasury stock and then subsequently retired. In accordance with the LLC Agreement, the LLC must redeem an equal number of LLC Units held by us as shares of Class A Common Stock repurchased by us at a redemption price equal to the redemption price paid for the Class A Common Stock repurchased by us.

We intend to fund repurchases under the Repurchase Program from cash on hand. During fiscal year 2016, we purchased 287,346 shares of Class A Common Stock at an average stock price of $13.82 per share for an aggregate purchase price of approximately $4.0 million including related fees and expenses. In addition, 287,346 LLC Units held by us were redeemed and canceled by the LLC. As of June 30, 2016, we may repurchase up to an additional $11.0 million in shares of Class A Common Stock and LLC Units under the program.

Off-Balance Sheet Arrangements

Repurchase Commitments

In connection with our dealers’ wholesale floor plan financing of boats, we have entered into repurchase agreements with various lending institutions. The repurchase commitment is on an individual unit basis with a term from the date it is financed by the lending institution through payment date by the dealer, generally not exceeding two and a half years. Such agreements are customary in the industry and our exposure to loss under such agreements is limited by the resale value of the inventory which is required to be repurchased. Refer to Note 16 to the audited consolidated financial statements included elsewhere in this Annual Report for further information on repurchase commitments.

Contractual Obligations and Commitments

As of June 30, 2016, our continuing contractual obligations were as follows:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	(In thousands)				
Term debt [1]	$72,000	$8,000	$16,500	$47,500	$—
Interest expense [2]	7,241	2,303	3,806	1,132	—
Operating leases [3]	25,118	2,224	4,383	4,429	14,082
Purchase obligations [4]	16,519	16,519	—	—	—
Payments pursuant to tax receivable agreement [5]	93,750	4,189	9,324	9,987	70,250
Total	$214,628	$33,235	$34,013	$63,048	$84,332

(1) Principal payments on term loan facility pursuant to Amended and Restated Credit Agreement due April 2, 2020. We had no amounts outstanding under our revolving credit facility as of June 30, 2016. We may borrow up to $25.0 million under our revolving credit facility which matures on April 2, 2020. On August 4, 2016, the Company paid down $15.0 million in principal on its term loan.

(2) Interest payments on term loan facility pursuant to Amended and Restated Credit Agreement due April 2, 2020. We had no amounts outstanding under our revolving credit facility as of June 30, 2016. We may borrow up to $25.0 million under our revolving credit facility which matures on April 2, 2020.

(3) We sold our two primary manufacturing and office facilities for a total of $18.3 million in 2008, which resulted in a gain of $0.7 million. Simultaneous with the sale, we entered into an agreement to lease back the buildings for an initial term of 20 years. The net gain of $0.2 million has been deferred and is being amortized in proportion to rent charged over the initial lease term.

(4) As part of the normal course of business, we enter into purchase orders from a variety of suppliers, primarily for raw materials, in order to manage our various operating needs. The orders are expected to be purchased throughout fiscal years 2017.

(5) In connection with the Recapitalization and IPO, we entered into a tax receivable agreement with the pre-IPO owners of the LLC that provides for the payment by us to the pre-IPO owners (or any permitted assignees) of 85% of the amount of cash savings, if any, in U.S. federal, state and local income tax or franchise tax that we actually

realize, or in some circumstances are deemed to realize, as a result of an expected increase in our share of tax basis in LLC's tangible and intangible assets, including increases attributable to payments made under the tax receivable agreement. These obligations will not be paid if we do not realize cash tax savings.

Our dealers have arrangements with certain finance companies to provide secured floor plan financing for the purchase of our products. These arrangements indirectly provide liquidity to us by financing dealer purchases of our products, thereby minimizing the use of our working capital in the form of accounts receivable. A majority of our sales are financed under similar arrangements, pursuant to which we receive payment within a few days of shipment of the product. We have agreed to repurchase products repossessed by the finance companies if a dealer defaults on its debt obligations to a finance company and the boat is returned to us, subject to certain limitations. Our financial exposure under these agreements is limited to the difference between the amounts unpaid by the dealer with respect to the repossessed product plus costs of repossession and the amount received on the resale of the repossessed product. During fiscal year 2016, we agreed to repurchase three units from the lender of two of our former dealers resulting in combined losses of $0.03 million. No units were repurchased for fiscal years 2015 and 2014. An adverse change in retail sales could require us to repurchase repossessed units upon an event of default by any of our dealers, subject to the annual limitation.

Seasonality

Our dealers experience seasonality in their business. Retail demand for boats is seasonal, with a significant majority of sales occurring during peak boating season, which coincides with our first and fourth fiscal quarters. In order to minimize the impact of this seasonality on our business, we manage our manufacturing processes and structure dealer incentives to tie our annual volume rebates program to consistent ordering patterns, encouraging dealers to purchase our products throughout the year. In this regard, we may offer free flooring incentives to dealers from the beginning of our model year through April 30 of each year. Further, in the event that a dealer does not consistently order units throughout the year, such dealer’s rebate is materially reduced. We may offer off-season retail promotions to our dealers in seasonally slow months, during and ahead of boat shows, to encourage retail demand.

Emerging Growth Company

We are an “emerging growth company,” as defined in the JOBS Act. For as long as we are an “emerging growth company,” we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies,” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404(b) of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions from the requirements of holding stockholder advisory “say-on-pay” votes on executive compensation and stockholder advisory votes on golden parachute compensation.

The JOBS Act also provides that an “emerging growth company” can utilize the extended transition period provided in Section 7(a)(2)(B) of the Securities Act, for complying with new or revised accounting standards. Pursuant to Section 107 of the JOBS Act, we have chosen to “opt out” of such extended transition period and, as a result, we will comply with new or revised accounting standards on the relevant dates on which adoption of such standards is required for companies that are not “emerging growth companies.” Under the JOBS Act, our decision to opt out of the extended transition period for complying with new or revised accounting standards is irrevocable.

We will continue to be an emerging growth company until the earliest to occur of (i) the last day of the fiscal year during which we had total annual gross revenues of at least $1 billion (as indexed for inflation), (ii) the last day of the fiscal year following the fifth anniversary of the closing of the IPO, (iii) the date on which we have, during the previous three-year period, issued more than $1 billion in non-convertible debt or (iv) the date on which we are deemed to be a "large accelerated filer," as defined under the Exchange Act. Accordingly, we could remain an "emerging growth company" until as late as June 30, 2019.

Inflation

The market prices of certain materials and components used in manufacturing our products, especially resins that are made with hydrocarbon feedstocks, copper, aluminum and stainless steel, can be volatile. Historically, however, inflation has not had a material effect on our results of operations. Significant increases in inflation, particularly those related to wages and increases in the cost of raw materials, could have an adverse impact on our business, financial condition and results of operations.

New boat buyers often finance their purchases. Inflation typically results in higher interest rates that could translate into an increased cost of boat ownership. Should inflation and increased interest rates occur, prospective consumers may choose to forgo or delay their purchases or buy a less expensive boat in the event credit is not available to finance their boat purchases.

Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with GAAP. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, expenses and cash flows, and related disclosure of contingent assets and liabilities. Our estimates include those related to goodwill, revenue recognition, dealer incentives, product repurchases and warranty claims. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected. We believe that of our significant accounting policies, which are described in the notes to our audited consolidated financial statements appearing elsewhere in this Annual Report, the accounting policies listed below involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to understand and evaluate fully our financial condition and results of operations.

Goodwill

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized. Goodwill amounts are not amortized, but rather are evaluated for potential impairment on an annual basis, as of June 30, unless circumstances indicate the need for impairment testing between the annual tests in accordance with the provisions of Accounting Standards Codification, or ASC Topic 350, "Intangibles—Goodwill and Other." If this assessment indicates the possibility of impairment, the income approach to test for goodwill impairment would be used unless circumstances indicate that a better estimate of fair value was available. Under the income approach, management calculates the fair value of each reporting unit based on the present value of estimated future cash flows. If the fair value of the reporting unit exceeds the carrying value of the net assets including goodwill assigned to that unit, goodwill is not impaired. If the carrying value of the reporting unit's net assets including goodwill exceeds the fair value of the reporting unit, then management determines the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then we would record an impairment loss equal to the difference. We did not recognize any goodwill impairment charges in the fiscal years ended June 30, 2016, 2015 and 2014.

Revenue Recognition

We generally manufacture products based on specific orders from dealers and often ship completed products only after receiving credit approval from third-party financial institutions or those participating in floor financing programs. Revenue associated with sales to dealers financed through either source is primarily recorded when all of the following conditions have been met:

- an order for a product has been received;
- a common carrier signs the delivery ticket accepting responsibility for the product; and
- the product is removed from our property for delivery.

These conditions are generally met when title passes, which is when boats are shipped to dealers in accordance with shipping terms, which are primarily free on board shipping point.

Dealers generally have no rights to return unsold boats. From time to time, however, we may accept returns in limited circumstances and at our discretion under our warranty policy, which generally limits returns to instances of manufacturing defects. We estimate the costs that may be incurred under our basic limited warranty and record a liability in the amount of such costs at the time the product revenue is recognized. We may also be obligated, in the event of default by a dealer, to accept returns of unsold boats under our repurchase commitment to floor financing providers, which are able to obtain such boats through foreclosure. We accrue estimated losses when a loss, due to the default of one of our dealers, is determined to be probable and the amount of the loss is reasonably estimable. Refer to Notes 8 and 16 to our audited consolidated financial statements included elsewhere in this Annual Report for more information related to our product warranty and repurchase commitment obligations, respectively.

Revenue from boat part sales is recorded as the product is shipped from our location, which is free on board shipping point. Revenue associated with sales of materials, parts, boats or engine products sold under our exclusive manufacturing and distribution agreement with our Australian licensee prior to the closing date of its acquisition were recognized under free-on-board port of disembarkment terms, the point at which the risks of ownership and loss passed to the licensee. Revenue from our Australia operations recognized after the acquisition date is eliminated in consolidation. We also earned royalties from our Australian licensee prior to its acquisition, which were accrued on a monthly basis based on a percentage of the licensee's gross sales. Royalties earned were paid to us on a quarterly basis. Royalty income earned after the acquisition date is eliminated in consolidation.

Revenue associated with sales to the independent representative responsible for international sales is recognized in accordance with free on board shipping point terms, the point at which the risks of ownership and loss pass to the representative. A fixed percentage discount is earned by the independent representative at the time of shipment to the

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representative as a reduction in the price of the boat and is recorded in our consolidated statement of operations as a reduction in sales.

Dealer Incentives

We provide for various structured dealer rebate and sales promotions incentives, which are recognized as a reduction in net sales, at the time of sale to the dealer. Examples of such programs include rebates, seasonal discounts, promotional co-op arrangements and other allowances. Dealer rebates and sales promotion expenses are estimated based on current programs and historical achievement and/or usage rates. Actual results may differ from these estimates if market conditions dictate the need to enhance or reduce sales promotion and incentive programs or if dealer achievement or other items vary from historical trends. Free floor financing incentives are estimated at the time of sale to the dealer based on the expected expense to us over the term of the free flooring period and are recognized as a reduction in sales.

Income Taxes

Malibu Boats, Inc. is taxed as a C corporation for U.S. income tax purposes and is therefore subject to both federal and state taxation at a corporate level. Following the IPO, the LLC continues to operate in the United States as a partnership for U.S. federal income tax purposes.

We file various federal and state tax returns, including some returns that are consolidated with subsidiaries. We account for the current and deferred tax effects of such returns using the asset and liability method. Significant judgments and estimates are required in determining our current and deferred tax assets and liabilities, which reflect our best assessment of the estimated future taxes we will pay. These estimates are updated throughout the year to consider income tax return filings, our geographic mix of earnings, legislative changes and other relevant items.

We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts of assets and liabilities and the amounts applicable for income tax purposes. Deferred tax assets represent items to be realized as a tax deduction or credit in future tax returns. Realization of the deferred tax assets ultimately depends on the existence of sufficient taxable income of the appropriate character in either the carryback or carryforward period.

Each quarter we analyze the likelihood that our deferred tax assets will be realized. A valuation allowance is recorded if, based on the weight of all available positive and negative evidence, it is more likely than not (a likelihood of more than 50%) that some portion, or all, of a deferred tax asset will not be realized. A summary of our deferred tax assets is included in Note 11 to our audited consolidated financial statements included elsewhere in this Annual Report.

On an annual basis, we perform a comprehensive analysis of all forms of positive and negative evidence based on year end results. During each interim period, we update our annual analysis for significant changes in the positive and negative evidence.

If we later determine that realization is more likely than not for deferred tax assets with a valuation allowance, the related valuation allowance will be reduced. Conversely, if we determine that it is more likely than not that we will not be able to realize a portion of our deferred tax assets, we will increase the valuation allowance.

We recognize a tax benefit associated with an uncertain tax position when, in our judgment, it is more likely than not that the position will be sustained based upon the technical merits of the position. For a tax position that meets the more-likely-than-not recognition threshold, we initially and subsequently measure the income tax benefit as the largest amount that we judge to have a greater than 50% likelihood of being realized. Our liability associated with unrecognized tax benefits is adjusted periodically due to changing circumstances, such as the progress of tax audits, case law developments and new or emerging legislation. Such adjustments are recognized entirely in the period in which they are identified. Our income tax provision includes the net impact of changes in the liability for unrecognized tax benefits.

The Company has filed federal and state income tax returns that remain open to examination for years 2014 through 2015, while its subsidiaries, Malibu Boats Holdings, LLC and Malibu Boats Pty Ltd., remain open to examination for years 2012 through 2015. While it is often difficult to predict the final outcome or the timing of resolution of any particular tax matter, we believe our liability for unrecognized tax benefits is adequate.

We consider an issue to be resolved at the earlier of the issue being “effectively settled,” settlement of an examination, or the expiration of the statute of limitations. Upon resolution, unrecognized tax benefits will be reversed as a discrete event.

Our liability for unrecognized tax benefits is generally presented as noncurrent. However, if we anticipate paying cash within one year to settle an uncertain tax position, the liability is presented as current. We classify interest and penalties recognized on the liability for unrecognized tax benefits as income tax expense.

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Tax Receivable Agreement

As a result of exchanges of LLC Units into Class A Common Stock and purchases by us of LLC Units from holders of LLC Units, we will become entitled to a proportionate share of the existing tax basis of the assets of the LLC at the time of such exchanges or purchases. In addition, such exchanges or purchases of LLC Units are expected to result in increases in the tax basis of the assets of the LLC that otherwise would not have been available. These increases in tax basis may reduce the amount of tax that we would otherwise be required to pay in the future. These increases in tax basis may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets.

In connection with the Recapitalization and IPO, we entered into a tax receivable agreement with the pre-IPO owners of the LLC that provides for the payment by us to the pre-IPO owners (or any permitted assignees) of 85% of the amount of the benefits, if any, that we are deemed to realize as a result of (i) increases in tax basis and (ii) certain other tax benefits, including those attributable to payments, under the tax receivable agreement. These contractual payment obligations are our obligations and are not obligations of the LLC, and are accounted for in accordance with ASC 450, Contingencies, since the obligations were deemed to be probable and reasonably estimable. For purposes of the tax receivable agreement, the benefit deemed realized by us will be computed by comparing our actual income tax liability (calculated with certain assumptions) to the amount of such taxes that we would have been required to pay had there been no increase to the tax basis of the assets of the LLC as a result of the purchases or exchanges, and had we not entered into the tax receivable agreement.

The timing and/or amount of aggregate payments due under the tax receivable agreement may vary based on a number of factors, including the amount and timing of the taxable income we generate in the future and the tax rate then applicable and amortizable basis.

The term of the tax receivable agreement will continue until all such tax benefits have been utilized or expired, unless we exercise our right to terminate the tax receivable agreement for an amount based on the agreed payments remaining to be made under the agreement. In certain mergers, asset sales or other forms of business combinations or other changes of control, we (or our successor) would owe to the pre-IPO owners of the LLC (or any permitted assignees) a lump-sum payment equal to the present value of all forecasted future payments that would have otherwise been made under the tax receivable agreement that would be based on certain assumptions, including a deemed exchange of all LLC Units and that we would have had sufficient taxable income to fully utilize the deductions arising from the increased tax basis and other tax benefits related to entering into the tax receivable agreement.

Repurchase Commitments

In connection with our dealers' wholesale floor plan financing of boats, we have entered into repurchase agreements with various lending institutions. The repurchase commitment is on an individual unit basis with a term from the date it is financed by the lending institution through payment date by the dealer, generally not exceeding two and a half years. Such agreements are customary in the industry and our exposure to loss under such agreements is limited by the resale value of the inventory which is required to be repurchased. During fiscal year 2016, we agreed to repurchase three units from the lender of two of our former dealers for combined losses of less than $0.03 million. Other than these repurchase commitments, we have not repurchased another unit from lenders since July 1, 2010.

Product Warranties

Effective for model year 2016, the Company began providing a limited warranty for a period up to five years for both Malibu and Axis brand boats. For model years prior to 2016, the Company provided a limited warranty for a period of up to three years for its Malibu brand boats and two years for its Axis products. Our standard warranties require us or our dealers to repair or replace defective products during the warranty period at no cost to the consumer. We estimate the costs that may be incurred under our basic limited warranty and record as a liability in the amount of such costs at the time the product revenue is recognized. Factors that affect our warranty liability include the number of units sold, historical and anticipated rates of warranty claims, and cost per claim. We utilize historical trends and analytical tools to assist in determining the appropriate warranty liability. The extension of our warranty coverage period is expected to continue to increase our obligations to cover warranty claims over time resulting in an increase in our reserve to cover these warranty claims. We periodically assess the adequacy of the recorded warranty liabilities by brand and will adjust the amounts as necessary based on the best available information and trends.

New Accounting Pronouncements

See "Part II, Item 8. Financial Statements and Supplementary Data—Note 1—Organization, Basis of Presentation, and Summary of Significant Accounting Policies—New Accounting Pronouncements."

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of loss that may impact our financial condition through adverse changes in financial market prices and rates and inflation. Changes in these factors could cause fluctuations in our results of operations and cash flows. In the ordinary course of business, we are primarily exposed to foreign exchange rate and interest rate risks. We manage our exposure to these market risks through regular operating and financing activities. In the past, we have also attempted to reduce our market risks through hedging instruments such as interest rate swaps.

Foreign Exchange Rate Risk

We have operations both within the United States and Australia, and we are exposed to market risks in the ordinary course of our business. These risks primarily include foreign exchange rate and inflation risks. Our Australian operations purchase key components from our U.S. operations, as well as other U.S. based suppliers, and pay for these purchases in U.S. dollars. Fluctuations in the foreign exchange rate of the U.S. dollar against the Australian dollar have resulted in a foreign currency transaction loss of $0.1 million and $0.2 million for the fiscal years ended June 30, 2016 and 2015, respectively. We are also subject to risks relating to changes in the general economic conditions in the countries where we conduct business. To reduce certain of these risks to our Australian operations, we monitor, on a regular basis, the financial condition and position of the subsidiary. We do not use derivative instruments to mitigate the impact of our foreign exchange rate risk exposures.

Additionally, the assets and liabilities of our Australian subsidiary are translated at the foreign exchange rate in effect at the balance sheet date. Translation gains and losses are reflected as a component of accumulated other comprehensive loss in the stockholders’ equity section of the accompanying consolidated balance sheets. Revenues and expenses of our foreign subsidiary are translated at the average foreign exchange rate in effect for each month of the quarter. Certain assets and liabilities related to intercompany positions reported on our consolidated balance sheet that are denominated in a currency other than the functional currency are translated at the foreign exchange rates at the balance sheet date and the associated gains and losses are included in net income.

Interest Rate Risk

We are subject to interest rate risk in connection with borrowings under our credit agreement which bears interest at variable rates. At June 30, 2016, we had a $72.0 million term loan outstanding under our term loan facility and no outstanding debt under our revolving credit facility. As of June 30, 2016, the undrawn borrowing availability under the revolving line of credit was $25.0 million. Borrowings under the term loan and revolving credit facility bear interest at our option of (i) the highest of the prime rate, the Federal Funds Rate plus 0.5%, or one-month LIBOR plus 1%, which is the Base Rate, or (ii) LIBOR, in each case plus an applicable margin ranging from 1.00% to 1.75% with respect to Base Rate borrowings and 2.00% to 2.75% with respect to LIBOR borrowings. Therefore, our income and cash flows will be exposed to changes in interest rates to the extent that we do not have effective hedging arrangements in place.

At June 30, 2016, the interest rate on our term loan was 2.96%. Based on a sensitivity analysis at June 30, 2016, assuming no amounts are outstanding under our revolving credit facility for a full year, a 100 basis point increase in interest rates would increase our annual interest expense by approximately $0.3 million, after taking into account our principal payment of $15.0 million on our term loan on August 4, 2016.

On July 1, 2015, we entered into a 5-year floating to fixed interest rate swap with a certain counterparty to the Amended and Restated Credit Agreement to mitigate the risk of interest rate fluctuations associated with our variable rate long term debt. The swap has an effective start date of July 1, 2015 and is based on a one-month LIBOR rate versus a 1.52% fixed rate on a notional value of $39.3 million, which under terms of the Amended and Restated Credit Agreement is equal to 50% of the outstanding balance of the term loan at the time of the swap arrangement. For the fiscal year ended June 30, 2016, we recorded a loss of $0.9 million for the change in fair value of the interest rate swap, which is included in interest expense in the consolidated statements of operations and comprehensive income (loss).

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Item 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders
Malibu Boats, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Malibu Boats, Inc. and subsidiaries as of June 30, 2015, and the related consolidated statements of operations and comprehensive income (loss), members' and stockholders' equity, and cash flows for the years ended June 30, 2015 and 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Malibu Boats, Inc. and subsidiaries as of June 30, 2015, and the results of their operations and their cash flows for the years ended June 30, 2015 and 2014, in conformity with U.S. generally accepted accounting principles.

/s/ RSM US LLP

Indianapolis, Indiana
September 9, 2015, except for Note 1, under the heading Immaterial Correction of Errors in Prior Period, which is dated September 9, 2016

Report of Independent Registered Public Accounting Firm
The Board of Directors and Shareholders
Malibu Boats, Inc.:

We have audited the accompanying consolidated balance sheet of Malibu Boats, Inc. and subsidiaries as of June 30, 2016 and the related consolidated statements of operations and comprehensive income (loss), members' and stockholders' equity, and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Malibu Boats, Inc. and subsidiaries as of June 30, 2016, and the results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP
Knoxville, Tennessee
September 9, 2016

MALIBU BOATS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations and Comprehensive Income (Loss)
(In thousands, except share data)

	Fiscal Year Ended June 30,		
	2016	2015	2014
Net sales	$252,965	$228,621	$190,935
Cost of sales	186,145	168,192	140,141
Gross profit	66,820	60,429	50,794
Operating expenses:			
Selling and marketing	7,475	7,007	6,098
General and administrative	21,256	19,809	39,974
Amortization	2,185	2,463	5,177
Operating income (loss)	35,904	31,150	(455)
Other income (expense):			
Other	76	1,650	9
Interest expense	(3,884)	(954)	(2,962)
Other income (expense)	(3,808)	696	(2,953)
Net income (loss) before provision (benefit) for income taxes	32,096	31,846	(3,408)
Income tax provision (benefit)	11,801	8,663	(2,220)
Net income (loss)	20,295	23,183	(1,188)
Net income attributable to non-controlling interest	2,253	8,522	3,488
Net income (loss) attributable to Malibu Boats, Inc.	$18,042	$14,661	$(4,676)
Comprehensive income (loss):			
Net income (loss)	$20,295	$23,183	$(1,188)
Other comprehensive loss, net of tax:			
Change in cumulative translation adjustment	(390)	(2,081)	—
Other comprehensive loss, net of tax	(390)	(2,081)	—
Comprehensive income (loss), net of tax	19,905	21,102	(1,188)
Less: comprehensive income attributable to non-controlling interest, net of tax	2,214	7,757	3,488
Comprehensive income (loss) attributable to Malibu Boats, Inc., net of tax	$17,691	$13,345	$(4,676)
			For Period from February 5, 2014 to June 30, 2014
Weighted average shares outstanding used in computing net income (loss) per share:			
Basic	17,934,580	15,732,531	11,055,310
Diluted	17,985,427	15,741,018	11,055,310
Net income (loss) available to Class A Common Stock per share:			
Basic	$1.01	$0.93	$(0.42)
Diluted	$1.00	$0.93	$(0.42)

The accompanying notes are an integral part of these Consolidated Financial Statements.

MALIBU BOATS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except share data)

	June 30, 2016	June 30, 2015
Assets		
Current assets		
Cash	$25,921	$8,387
Trade receivables, net	14,690	9,482
Inventories, net	20,431	20,393
Prepaid expenses and other current assets	2,707	1,370
Income tax receivable	965	—
Total current assets	64,714	39,632
Property and equipment, net	17,813	14,946
Goodwill	12,470	12,665
Other intangible assets, net	11,703	13,995
Deferred tax assets	113,798	118,974
Other assets	32	102
Total assets	$220,530	$200,314
Liabilities		
Current liabilities		
Current maturities of long-term debt	$8,000	$6,500
Accounts payable	16,158	9,151
Accrued expenses	19,055	14,135
Income tax and distribution payable	427	784
Payable pursuant to tax receivable agreement, current portion	4,189	2,969
Total current liabilities	47,829	33,539
Deferred tax liabilities	685	872
Other liabilities	1,136	275
Payable pursuant to tax receivable agreement, less current portion	89,561	93,501
Long-term debt, less current maturities	63,086	70,842
Total liabilities	202,297	199,029
Commitments and contingencies (See Note 16)		
Equity		
Class A Common Stock, par value $0.01 per share, 100,000,000 shares authorized; 17,690,874 shares issued and outstanding as of June 30, 2016; 17,858,726 shares issued and outstanding as of June 30, 2015	176	178
Class B Common Stock, par value $0.01 per share, 25,000,000 shares authorized; 23 shares issued and outstanding as of June 30, 2016; 24 shares issued and outstanding as of June 30, 2015	—	—
Preferred Stock, par value $0.01 per share; 25,000,000 shares authorized; no shares issued and outstanding as of June 30, 2016; no shares issued and outstanding as of June 30, 2015	—	—
Additional paid in capital	44,151	45,529
Accumulated other comprehensive loss	(2,471)	(2,081)
Accumulated deficit	(28,302)	(46,239)
Total stockholders' equity (deficit) attributable to Malibu Boats, Inc.	13,554	(2,613)
Non-controlling interest	4,679	3,898
Total stockholders' equity	18,233	1,285
Total liabilities and equity	$220,530	$200,314

The accompanying notes are an integral part of these Consolidated Financial Statements.

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MALIBU BOATS, INC. AND SUBSIDIARIES
Consolidated Statements of Members’ and Stockholders' Equity
(In thousands, except number of Class B shares)

	Malibu Boats Holdings, LLC									Malibu Boats, Inc.									
	Units									Common Stock									
	LLC Units		Class A Units		Class B Units		Class M Units		Accumulated (Deficit) Earnings	Class A		Class B		Additional Paid In Capital	Noncontrolling Interest in LLC	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Total Members'/Stockholders' Equity
	Units	Amount	Units	Amount	Units	Amount	Units	Amount		Shares	Amount	Shares	Amount						
Balance at June 30, 2013	—	$—	36,742	$16,978	3,885	$(2,417)	1,421	$(460)	$5,913	—	$—	—	$—	$—	$—	$—	$—	$—	$20,014
Net income before February 5, 2014									10,448										10,448
Stock based compensation before February 5, 2014								76											76
Membership units vested before February 5, 2014							304												—
Distributions to non-controlling unit holders before February 5, 2014				(55,172)		(6,474)		(2,981)							—				(64,627)
Recapitalization Transactions:																			
Issuance of Class A Common Stock for merger of entities in Recapitalization										3,412	34			47,732					47,766
Exchange of LLC Units held by selling shareholders for Class A Common Stock upon merger of entities in Recapitalization														(47,766)					(47,766)
Conversion of previous classes of units into LLC units as part of the Recapitalization	11,374	(50,450)	(36,742)	38,194	(3,885)	8,891	(1,725)	3,365											—

Initial Public Offering Transactions:							
Allocation of non-controlling interest in LLC	(11,374)	50,450	(16,361)			(5)2,483,344	—
Issuance of Class A Common Stock for IPO, net of underwriting discounts				7,643	76	99,436	99,512

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Issuance of Class B Common Stock				44	—					—
Purchase of LLC Units from existing owners of LLC						(29,762)				(29,762)
Increase in payable pursuant to the tax receivable agreement						(13,636)				(13,636)
Increase in deferred tax asset from step-up in tax basis						18,303				18,303
Capitalized offering costs						(1,550)				(1,550)
Stock based compensation						2,501				2,501
Distributions to non-controlling unit holders							(2,583)			(2,583)
Issuance of equity for services		9	—			1,010				1,010
Net loss after February 5, 2014							(6,960)	(4,676)		(11,636)
Balance at June 30, 2014	~~$ $ $ $ $~~	11,064	$110	44	$—	$23,835	$8,801	$(4,676)	$— $ —	$28,070
Net income							8,522	14,661		23,183
Issuance of Class A Common Stock for public offerings, net of underwriting discounts		4,371	73			133,289				133,362
Purchase of Class A Common Stock from selling shareholders						(56,526)				(56,526)
Purchase of units from existing LLC Unit holders						(76,836)				(76,836)
Exchange of LLC Units for Class A Common Stock		5,583	26			(26)				—
Repurchase of Class A Common Stock									(71,523)	(71,523)
Retirement of treasury shares		(3,333)	(33)			(15,266)		(56,224)	71,523	—

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Reallocation of non-controlling interest from selling shareholders acquired in offerings [1]						11,687	(11,687)				—
Stock based compensation						1,467					1,467
Issuances of equity for services		3				252					252
Cancellation of Class B Common Stock				(20)							—
Capitalized offering costs						(1,498)					(1,498)
Increase in payable pursuant to the tax receivable agreement						(82,834)					(82,834)
Increase in deferred tax asset from step-up in tax basis [1]						105,181					105,181
Distributions to LLC Unit holders						(31)	(1,738)				(1,769)
Issuance of Class A Common Stock for acquisition		171	2			2,835					2,837
Foreign currency translation adjustment									(2,081)		(2,081)
Balance at June 30, 2015	$— $— $— $— $—	17,859	$178	24	$—	$45,529	$3,898	$(46,239)	$(2,081)	$—	$1,285
Net income							2,253	18,042			20,295
Stock based compensation, net of withholding taxes on vested equity awards		96	1			1,791					1,792
Issuances of equity for services		9				751					751
Increase in payable pursuant to the tax receivable agreement						(118)					(118)
Increase in deferred tax asset from step-up in tax basis						140					140
Exchange of LLC Units for Class A Common Stock		14				39	(39)				—
Cancellation of Class B Common Stock				(1)							—

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Distributions to LLC Unit holders						(1,433)	(105)	(1,538)
Repurchase and retirement of common stock				(288)	(3)	(3,981)		(3,984)
Foreign currency translation adjustment							(390)	(390)
Balance at June 30, 2016	—$	1,010	(261)	11,096				
Total	**$ 279,973**	**$ 8,764**	**$ (712)**	**$ 288,025**				

2009 *(in thousands)*	**Amortized Cost**	**Available-for-Sale** **Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Obligations of U.S. government corporations and agencies	$ 126,588	$ 1,461	$ (78)	$ 127,971
Collateralized mortgage obligations of U.S. government corporations and agencies	58,010	2,219		60,229
Mortgage-backed securities of U.S. government corporations and agencies	58,834	2,687		61,521
Obligations of states and political subdivisions	91,146	2,013	(231)	92,928
Debt Securities Available-for-Sale	**334,578**	**8,380**	**(309)**	**342,649**
Marketable equity securities	12,652	741	(1,182)	12,211
Total	**$ 347,230**	**$ 9,121**	**$ (1,491)**	**$ 354,860**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

There were $0.4 million, $0.2 million and $3.4 million in gross realized gains and $0.1 million, $5.3 million and $5.1 million in gross realized losses in 2010, 2009 and 2008, in each case respectively, relating to securities available-for-sale.

The following tables present the estimated fair value and the age of gross unrealized losses by investment category:

	Less Than 12 Months		12 Months or More		Total	
2010 *(in thousands)*	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
Obligations of U.S. government corporations and agencies	$ 20,558	$ (215)	$	$	$ 20,558	$ (215)
Collateralized mortgage obligations of U.S. government corporations and agencies						
Mortgage-backed securities of U.S. government corporations and agencies						
Obligations of states and political subdivisions	13,167	(194)	917	(42)	14,084	(236)
Debt Securities Available-for-Sale	**33,725**	**(409)**	**917**	**(42)**	**34,642**	**(451)**
Marketable equity securities	2,068	(261)			2,068	(261)
Total Temporarily Impaired Securities	**$ 35,793**	**$ (670)**	**$ 917**	**$ (42)**	**$ 36,710**	**$ (712)**

	Less Than 12 Months		12 Months or More		Total	
2009 *(in thousands)*	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
Obligations of U.S. government corporations and agencies	$ 20,912	$ (78)	$	$	$ 20,912	$ (78)
Collateralized mortgage obligations of U.S. government corporations and agencies						
Mortgage-backed securities of U.S. government corporations and agencies						
Obligations of states and political subdivisions	5,969	(84)	3,881	(147)	9,850	(231)
Debt Securities Available-for-Sale	**26,881**	**(162)**	**3,881**	**(147)**	**30,762**	**(309)**
Marketable equity securities	8,385	(1,182)			8,385	(1,182)
Total Temporarily Impaired Securities	**$ 35,266**	**$ (1,344)**	**$ 3,881**	**$ (147)**	**$ 39,147**	**$ (1,491)**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

S&T does not believe any individual unrealized loss as of December 31, 2010 represents an OTTI. Refer to Note 1 Summary of Significant Accounting Policies for S&T s accounting policy surrounding securities and OTTI.

As of December 31, 2010, the unrealized losses on 39 debt securities were primarily attributable to changes in interest rates. The unrealized losses on 10 marketable equity securities as of December 31, 2010 were attributable to temporary declines in estimated fair value. S&T does not intend to sell and it is not likely that S&T will be required to sell any of the securities, referenced in the table above, in an unrealized loss position before recovery of its amortized cost.

Net unrealized gains of $5.2 million and $5.0 million were included in accumulated other comprehensive loss, net of tax, at December 31, 2010 and 2009, respectively. Gross unrealized gains of $5.7 million and $6.0 million were netted against gross unrealized losses of $0.5 million and $1.0 million, respectively, for these same periods. During 2010 and 2009, approximately $0.4 million and $0.2 million, respectively, of unrealized gains were reclassified out of accumulated other comprehensive loss into earnings, while $0.1 million and $5.3 million, respectively, of unrealized losses were reclassified into earnings to record OTTI.

The amortized cost and estimated fair value of available-for-sale securities at December 31, 2010, by contractual maturity, are included in the table below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Available-for-Sale *(in thousands)*	**Amortized Cost**	**Estimated Fair Value**
Due in one year or less	$ 12,726	$ 13,114
Due after one year through five years	135,795	138,068
Due after five years through ten years	9,395	9,560
Due after ten years	30,547	30,705
	188,463	**191,447**
Collateralized mortgage obligations of U.S. government corporations and agencies	39,790	41,491
Mortgage-backed securities of U.S. government corporations and agencies	41,373	43,991
Total Debt Securities Available-for-Sale	**269,626**	**276,929**
Marketable equity securities	10,347	11,096
Total	**$ 279,973**	**$ 288,025**

At December 31, 2010 and 2009, securities with principal amounts of $209.3 million and $251.4 million, respectively, were pledged to secure repurchase agreements, public funds and trust fund deposits.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 8. LOANS AND LOANS HELD FOR SALE

The following table presents the composition of the loan portfolio at December 31:

(in thousands)	**2010**	**2009**
Consumer:		
Home equity	$ 441,096	$ 458,643
Residential mortgage	359,536	357,393
Consumer installment	74,780	81,141
Consumer construction	4,019	11,836
Total Consumer Loans	879,431	909,013
Commercial:		
Commercial real estate	1,494,202	1,428,329
Commercial and industrial	722,359	701,650
Commercial construction	259,598	359,342
Total Commercial Loans	2,476,159	2,489,321
Gross Portfolio Loans	3,355,590	3,398,334
Allowance for loan losses	(51,387)	(59,580)
Total Portfolio Loans	3,304,203	3,338,754
Loans held for sale	8,337	6,073
Total Loans	**$ 3,312,540**	**$ 3,344,827**

S&T attempts to limit its exposure to credit risk by diversifying its loan portfolio and actively managing concentrations. When concentrations exist in certain segments, S&T mitigates this risk by monitoring the relevant economic indicators and internal risk rating trends, and through stress testing of the loans in those segments. Since S&T is primarily a lender to businesses in western Pennsylvania, there is a concentration in commercial loans as well as a geographic loan concentration in Pennsylvania. Commercial loans represent 74 percent and 73 percent of total gross loans at December 31, 2010 and 2009 respectively. Within the commercial portfolio, the commercial real estate and commercial construction portfolios combined comprise 71 percent of commercial loans and 52 percent of total loans at December 31, 2010. Further segmentation of the commercial real estate and commercial construction portfolios by industry and collateral type reveal no concentration in excess of 9 percent of total loans.

The vast majority of both commercial and consumer loans are made to businesses and individuals in S&T s western Pennsylvania market, resulting in a geographic concentration. The conditions of the local and regional economies are monitored closely through publicly available data as well as information supplied by our customers. Only the commercial real-estate and commercial construction portfolios combined have any significant out of state exposure, with 21 percent of the portfolio or 11 percent of total gross loans at December 31, 2010 being out of state. Management believes underwriting guidelines and ongoing review by loan administration mitigate the concentration risk present in the loan portfolio.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table presents a summary of nonperforming assets as of December 31:

(in thousands)	2010	2009
Nonperforming loans	$ 63,883	$ 90,807
OREO	5,820	4,607
Total Nonperforming Assets	**$ 69,703**	**$ 95,414**

OREO and other repossessed assets, which are included in other assets in the Consolidated Balance Sheets consists of 26 properties with one property comprising $1.5 million or 26 percent of the balance. All properties have current appraisals within the last 12 months per S&T policy.

The following table presents the restructured loans as of December 31:

	2010			2009		
(in thousands)	Performing Restructured Loans	Nonperforming Restructured Loans	Total Restructured Loans	Performing Restructured Loans	Nonperforming Restructured Loans	Total Restructured Loans
Commercial real estate	$ 1,194	$ 29,636	$ 30,830	$	$ 1,409	$ 1,409
Commercial & industrial	37	1,000	1,037			
Commercial construction		2,143	2,143			
Home equity						
Residential mortgage	908		908			
Consumer installment						
Consumer construction						
Ending Balance	**$ 2,139**	**$ 32,779**	**$ 34,918**	**$**	**$ 1,409**	**$ 1,409**

Restructured loans are loans that S&T, for economic or legal reasons related to a borrower s financial difficulties, grants a concession that it would not otherwise consider. A concession is considered to have been granted if any of the following occur: the effective rate on the restructured loan is less than the effective rate on the original loan, a reduction or forgiveness of principal, reduction or forgiveness of accrued interest, a reduction or deferral of principal, or an extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk.

S&T Bank has granted loans to certain officers and directors of S&T as well as to certain affiliates of the officers and directors in the ordinary course of business. These loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and did not involve more than normal risk of collectability.

The following table presents a summary of the aggregate amount of loans to any such persons as of December 31:

(in thousands)	2010	2009
Balance at beginning of year	$ 34,136	$ 36,622
New loans	20,594	14,808

Repayments	(20,357)	(17,294)
Balance at End of Year	**$ 34,373**	**$ 34,136**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 9. ALLOWANCE FOR LOAN LOSSES

S&T maintains an ALL at a level determined to be adequate to absorb estimated probable credit losses inherent in the loan portfolio as of the balance sheet date. Refer to Note 1 Summary of Significant Accounting Policies for details of S&T s ALL policy. During the fourth quarter of 2010, management implemented various enhancements to the ALL methodology to better align the calculation with the inherent risk identified within the loan portfolio. Changes included consideration of additional loan risk characteristics such as internal risk rating, collateral, and loan to value, enhancing the base loss calculation to consider the estimated loss emergence period of each loan class and expanding the qualitative adjustments to consider additional factors. The enhancements made to the ALL methodology did not materially change the ALL at December 31, 2010.

S&T develops and documents a systematic ALL methodology based the following portfolio segments: 1) CRE, 2) C&I, 3) Commercial Construction, 4) Consumer Real Estate and 5) Other Consumer. The following discusses key risk within each portfolio segment:

CRE Loans secured by commercial purpose real estate, including both owner occupied properties and investment properties for various purposes such as hotels, strip malls and apartments. Individual projects as well as global cash flows are the primary sources of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the collateral type as well as the business prospects of the lessee, if the project is not owner occupied.

C&I Loans made to operating companies or manufacturers for the purpose of production, operating capacity, accounts receivable, inventory or equipment financing. Cash flow from the operations of the company is the primary source of repayment for these loans. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the industry of the company. Collateral for these types of loans often do not have sufficient value in a distressed or liquidation scenario to satisfy the outstanding debt.

Commercial Construction Loans made to finance the construction or building of structures as well as to finance the acquisition and development of raw land for various purposes. While the risk of these loans is generally confined to the construction period, if there are problems, the project will not be complete, and as such, may not provide sufficient cash flow on its own to service the debt or have sufficient value in a liquidation to cover the outstanding principal. The condition of the local economy is an important indicator of risk, but there are also more specific risks depending on the type of project and the experience and resources of the developer.

Consumer Real Estate Loans secured by 1-4 family residences, including purchase money mortgages, 1st and 2nd lien home equity loans and home equity lines of credit. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk for this segment. The state of the local housing market can also have a significant impact on this portfolio, since low demand and/or declining home values can limit the ability of borrowers to sell a property and satisfy the debt.

Other Consumer Loans made to individuals that may be secured by assets other than 1-4 family residences, as well as unsecured loans. This segment includes auto loans, unsecured lines and credit cards. The primary source of repayment for these loans is the income and assets of the borrower. The condition of the local economy, in particular the unemployment rate, is an important indicator of risk for this segment. The value of the collateral, if there is any, is less likely to be a source of repayment due to less certain collateral values.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Management further assesses risk within each portfolio segment using the key inherent risk differentiators. For the commercial loan segments, the most important indicator of risk is the internally assigned risk rating, including pass, special mention and substandard. Impaired loans are considered in the ALL model separately and are individually evaluated for impairment. S&T s internal risk rating system is consistent with definitions found in current regulatory guidelines. A simplified data migration technique is used to calculate the historic average losses over the defined loss emergence period.

Loans in the consumer segments are not individually risk rated, so the most important indicators of risk are the existence of collateral, the type of collateral, and for consumer real estate loans, whether the bank has a 1st or 2nd lien position. A simplified data migration technique is used to calculate the historic average losses over the defined loss emergence period.

Management monitors various credit quality indicators for both the commercial and consumer loan portfolios, including delinquency, nonperforming status and changes in risk ratings on a monthly basis. Refer to Note 1, Summary of Significant Accounting Policies for S&T s policy for determining past due status of loans.

The following table presents the age analysis of past due loans segregated by class of loans at December 31:

2010 *(in thousands)*	**30-59 Days Past Due**	**60-89 Days Past Due**	**Non-performing**	**Total Past Due**	**Current**	**Total Loans**
Commercial real estate	$ 3,135	$ 1,236	$ 44,310	$ 48,681	$ 1,445,521	$ 1,494,202
Commercial & industrial	975	739	3,567	5,281	717,078	722,359
Commercial construction	99	736	7,987	8,822	250,776	259,598
Home equity	1,744	707	1,433	3,884	437,212	441,096
Residential mortgage	930	416	5,996	7,342	352,194	359,536
Consumer installment	275	67	65	407	74,373	74,780
Consumer construction			525	525	3,494	4,019
Ending Balance	**$ 7,158**	**$ 3,901**	**$ 63,883**	**$ 74,942**	**$ 3,280,648**	**$ 3,355,590**

Management continually monitors the commercial loan portfolio through its internal risk rating system. Loan risk ratings are assigned based upon the creditworthiness of the borrower. Loan risk ratings are reviewed on an ongoing basis according to internal policies. Loans within the pass rating generally have a lower risk of loss than loans risk rated as special mention, and substandard, which generally have an increasing risk of loss.

S&T s risk ratings are consistent with regulatory guidance and are as follows:

Pass The loan is currently performing and is of high quality.

Special Mention A special mention loan has potential weaknesses that warrant management s close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects or in the institution s credit position at some future date. Economic and market conditions, beyond the customer s control, may in the future necessitate this classification.

Substandard A substandard loan is not adequately protected by the net worth and/or paying capacity of the obligor or by the collateral pledged, if any. Substandard loans have a well-defined weakness, or weaknesses that jeopardize the liquidation of the debt. These loans are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table presents the recorded investment in commercial loan classes by credit quality indicator at December 31:

Commercial Credit Exposure

Credit Risk Profile by Creditworthiness Category

2010 *(in thousands)*	**Commercial Real Estate**	**Commercial & Industrial**	**Commercial Construction**
Pass	$ 1,297,242	$ 619,011	$ 221,492
Special mention	86,653	76,158	16,308
Substandard	110,307	27,190	21,798
Total	**$ 1,494,202**	**$ 722,359**	**$ 259,598**

Management monitors the delinquent status of the consumer portfolio on a monthly basis. Loans are considered nonperforming when interest and principal are 90 days or more past due or management has determined that a material deterioration in the borrower s financial condition exists. The risk of loss is generally highest for nonperforming loans.

The following table presents the recorded investment in consumer loan classes by credit quality indicator at December 31:

Consumer Credit Exposure

Credit Risk Profile Based on Payment Activity

2010 *(in thousands)*	**Home Equity**	**Residential Mortgage**	**Consumer Installment**	**Consumer Construction**
Performing	$ 439,663	$ 353,540	$ 74,715	$ 3,494
Nonperforming	1,433	5,996	65	525
Total	**$ 441,096**	**$ 359,536**	**$ 74,780**	**$ 4,019**

S&T management determines loans to be impaired when based upon current information and events it is probable that S&T will be unable to collect all interest and principal payments due according to the original contractual terms of the loan agreement. Refer to Note 1, Summary of Significant Accounting Policies for S&T s policy on evaluating loans for impairment and interest income.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table presents S&T s investment in loans considered to be impaired and related information on those impaired loans as of December 31:

2010 *(in thousands)*	**Recorded Investment**	**Unpaid Principal Balance**	**Related Allowance**	**Average Recorded Investment**	**Interest Income Recognized**
With a related allowance recorded:					
Commercial real estate	$ 10,152	$ 11,466	$ 1,992	$ 21,023	$ 489
Commercial & industrial	1,263	1,263	337	1,623	22
Commercial construction	4,662	4,662	1,302	7,165	
Total with a related allowance recorded	**16,077**	**17,391**	**3,631**	**29,811**	**511**
Without a related allowance recorded:					
Commercial real estate	29,788	37,567		28,074	442
Commercial & industrial	1,491	3,280		1,370	
Commercial construction	3,325	4,853		7,202	20
Total without a related allowance recorded	**34,604**	**45,700**		**36,646**	**462**
Total:					
Commercial real estate	39,940	49,033	1,992	49,096	931
Commercial & industrial	2,754	4,543	337	2,993	22
Commercial construction	7,987	9,515	1,302	14,367	20
Total	**$ 50,681**	**$ 63,091**	**$ 3,631**	**$ 66,456**	**$ 973**

The following table presents the ALL and recorded investments in loans by category as of December 31:

2010 *(in thousands)*	**Commercial Real Estate**	**Commercial & Industrial**	**Commercial Construction**	**Consumer Real Estate**	**Other Consumer**	**Total Loans**
Allowance for loan losses:						
Allowance for loans individually evaluated for impairment	$ 1,992	$ 337	$ 1,302	$ 0	$ 0	$ 3,631
Allowance for loans collectively evaluated for impairment	28,432	9,440	4,603	3,962	1,319	47,756
Total Allowance for Loan Losses	**30,424**	**9,777**	**5,905**	**3,962**	**1,319**	**51,387**
Portfolio loans:						
Individually evaluated for impairment	39,940	2,754	7,987	0	0	50,681
Collectively evaluated for impairment	1,454,262	719,605	251,611	804,651	74,780	3,304,909
Ending Balance	**$ 1,494,202**	**$ 722,359**	**$ 259,598**	**$ 804,651**	**$ 74,780**	**$ 3,355,590**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table presents changes in the ALL for the year ended December 31:

(in thousands)	2010	2009	2008
Balance at beginning of year	$ 59,580	$ 42,689	$ 34,345
Charge-offs	(41,027)	(56,862)	(12,170)
Recoveries	3,323	1,399	2,216
Net Charge-offs	**(37,704)**	**(55,463)**	**(9,954)**
Provision for loan losses	29,511	72,354	12,878
Acquired loan loss reserve			5,420
Balance at End of Year	**$ 51,387**	**$ 59,580**	**$ 42,689**

NOTE 10. PREMISES AND EQUIPMENT

The following table is a summary of premises and equipment at December 31:

(in thousands)	Estimated Useful Life	2010	2009
Land	Indefinite	$ 6,384	$ 6,129
Premises	10-50 years	41,470	41,036
Furniture and equipment	3-25 years	22,552	28,351
Leasehold improvements	2-37 years	4,781	5,031
		75,187	**80,547**
Accumulated depreciation		(35,233)	(39,557)
Total		**$ 39,954**	**$ 40,990**

Depreciation related to premises and equipment was $4.3 million, $4.3 million and $4.0 million in 2010, 2009 and 2008, respectively.

Certain banking facilities are leased under lease arrangements expiring at various dates until the year 2054. Those which contain escalation clauses, where the rent increases over the term of the lease, are accounted for on a straight-line basis. All leases are accounted for as operating leases, except for one capital lease entered into in the fourth quarter of 2008. Rental expense for premises amounted to $1.7 million, $1.9 million and $1.7 million in 2010, 2009 and 2008, respectively. Included in the rental expense for premises are leases entered into with two directors, which totaled $0.2 million, $0.2 million and $0.3 million in 2010, 2009 and 2008, respectively.

Minimum annual rental and renewal option payments for each of the following five years and thereafter are approximately:

(in thousands)	Operating	Capital	Total

2011	$ 1,457	$ 76	$ 1,533
2012	1,439	76	1,515
2013	1,453	76	1,529
2014	1,461	76	1,537
2015	1,452	76	1,528
Thereafter	33,724	992	34,716

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 11. GOODWILL AND OTHER INTANGIBLE ASSETS

The following table represents a roll forward of goodwill:

(in thousands)	**2010**	**2009**
Balance at beginning of year	$ 165,167	$ 163,546
Additions	106	1,621
Balance at End of Year	**$ 165,273**	**$ 165,167**

Goodwill represents the excess of the purchase price over the estimated fair value of net assets purchased. During 2009, an adjustment of $1.6 million to goodwill was recorded primarily relating to a tax adjustment for purchase accounting.

The following table shows a summary of intangible assets:

(in thousands)	**2010**	**2009**
Gross carrying amount	$ 15,070	$ 15,070
Accumulated amortization	(7,605)	(5,662)
Balance at End of Year	**$ 7,465**	**$ 9,408**

Intangible assets as of December 31, 2010 consisted of $6.5 million for the acquisition of core savings deposits, $0.3 million for the acquisition of wealth management relationships and $0.7 million for the acquisition of insurance contract relationships. S&T determined the amount of identifiable intangible assets based upon independent core deposit and insurance contract analyses. S&T did not record any intangible assets in 2010 or 2009.

Amortization expense on finite-lived intangible assets totaled $1.9 million, $2.3 million and $1.1 million for 2010, 2009 and 2008, respectively. Following is a summary of the expected amortization expense for finite-lived intangibles assets, assuming no new additions, for each of the five years following December 31, 2010:

(in thousands)	**Amount**
2011	$ 1,737
2012	1,542
2013	1,337
2014	911
2015	716

Goodwill and other intangible assets are reviewed annually for impairment and more frequently if impairment indicators exist. S&T completed this review in 2010 and 2009 and determined that its intangible assets are not impaired.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 12. DEPOSITS

The following table presents the composition of deposits and interest expense at December 31:

	2010		2009		2008	
(in thousands)	Balance	Interest Expense	Balance	Interest Expense	Balance	Interest Expense
Noninterest-bearing demand	$ 765,812	$	$ 712,120	$	$ 600,282	$
Interest-bearing demand	295,246	54	260,554	59	229,229	55
Money market	262,683	1,166	289,367	1,557	283,290	2,967
Savings	753,813	2,127	752,130	3,464	821,805	11,691
Certificates of deposit	1,239,970	25,370	1,290,370	33,358	1,293,810	37,650
Total	**$ 3,317,524**	**$ 28,717**	**$ 3,304,541**	**$ 38,438**	**$ 3,228,416**	**$ 52,363**

The aggregate of all certificates of deposit over $100,000 amounted to $451.6 million and $411.9 million at December 31, 2010 and 2009, respectively.

The following table indicates the scheduled maturities of certificates of deposit at December 31, 2010:

(in thousands)	Amount
2011	$ 665,631
2012	346,590
2013	121,351
2014	53,131
2015	44,610
Thereafter	8,657
Total	**$ 1,239,970**

NOTE 13. SHORT-TERM BORROWINGS

Short-term borrowings are for terms under one year and were comprised of retail repurchase agreements (REPOs), federal funds purchased, term auction facility (TAF) advances and FHLB advances. S&T defines repurchase agreements with its local retail customers as retail REPOs. Securities pledged as collateral under these REPO financing arrangements cannot be sold or repledged by the secured party and are therefore accounted for as a secured borrowing. The estimated fair value of collateral provided to a third party is continually monitored and additional collateral is obtained or requested to be returned as appropriate. Federal funds purchased are unsecured overnight borrowings with other financial institutions. TAF advances are collateral backed short-term loans with the Federal Reserve. FHLB advances are for various terms secured by a blanket lien on residential mortgages, other real estate secured loans and FHLB stock with the FHLB of Pittsburgh.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table represents the composition of short-term borrowings at December 31 and interest expense for the year ended December 31:

	2010		2009		2008	
(in thousands)	**Balance**	**Interest Expense**	**Balance**	**Interest Expense**	**Balance**	**Interest Expense**
Securities sold under repurchase agreements, retail	$ 40,653	$ 64	$ 44,935	$ 141	$ 113,419	$ 1,627
Federal funds purchased				1		123
Term auction facility				18		
Federal Home Loan Bank advances		146	51,300	526	308,475	4,263
Total	**$ 40,653**	**$ 210**	**$ 96,235**	**$ 686**	**$ 421,894**	**$ 6,013**

Information pertaining to REPOs, federal funds purchased and TAF advances are summarized in the table below:

(in thousands)	2010	2009	2008
Balance at December 31	$ 40,653	$ 44,935	$ 113,419
Average balance during the year	46,489	94,019	128,890
Average interest rate during the year	0.14%	0.17%	1.36%
Maximum month-end balance during the year	52,046	129,835	197,045
Average interest rate at December 31	0.10%	0.13%	0.39%

Information pertaining to FHLB advances is summarized in the table below:

(in thousands)	2010	2009	2008
Balance at December 31	$	$ 51,300	$ 308,475
Average balance during the year	32,473	96,929	227,918
Average interest rate during the year	0.45%	0.54%	1.87%
Maximum month-end balance during the year	141,800	195,150	377,850
Average interest rate at December 31	%	0.62%	0.59%

NOTE 14. LONG-TERM BORROWINGS

The purpose of long-term borrowings is to match-fund selected new loan originations, to mitigate interest rate sensitivity risks and to take advantage of discounted borrowing rates through the FHLB for community investment projects.

S&T had total borrowings as of December 31, 2010 and 2009 at the Pittsburgh FHLB of $29.1 million and $136.9 million, respectively. The total borrowings of $29.1 million in 2010 were long-term. Total borrowings for 2009 consisted of $51.3 million in short-term borrowings and $85.6 million in long-term borrowings. FHLB borrowings are collateralized by a blanket lien on residential mortgages, other real estate secured loans and FHLB stock with the FHLB of Pittsburgh. Total loans pledged as collateral at the FHLB were $2.2 billion at year end. S&T could have borrowed an additional $927.9 million based on qualifying collateral and $322.5 million more could be borrowed provided that additional collateral would have to be pledged.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

In addition, S&T currently has a $5.0 million line of credit with S&T Bank secured by investments of another subsidiary of S&T. The line of credit has a fixed rate of 3.25 percent and matures on April 22, 2011. At December 31, 2010 there were no funds drawn upon the line of credit.

Interest expense of $1.6 million, $5.6 million and $9.4 million was recognized on long-term borrowings for 2010, 2009 and 2008, respectively.

Scheduled annual maturities for all of the long-term debt for each of the five years and thereafter subsequent to December 31, 2010 are as follows:

(in thousands)	Balance	Average Rate
2011	$ 1,456	3.82%
2012	1,445	3.83%
2013	11,501	3.54%
2014	1,561	3.95%
2015	1,575	4.03%
Thereafter	11,827	3.19%
Total	**$ 29,365**	**3.48%**

Junior Subordinated Debt Securities

The following table represents the composition of junior subordinated debt securities at December 31:

	2010		2009		2008	
(in thousands)	Balance	Interest Expense	Balance	Interest Expense	Balance	Interest Expense
2006 Junior subordinated debt	$ 25,000	$ 1,695	$ 25,000	$ 1,695	$ 25,000	$ 1,695
2008 Junior subordinated debt trust preferred securities	20,619	782	20,619	912	20,619	1,038
2008 Junior subordinated debt	20,000	791	20,000	919	20,000	866
2008 Junior subordinated debt	25,000	735	25,000	887	25,000	780
Total	**$ 90,619**	**$ 4,003**	**$ 90,619**	**$ 4,413**	**$ 90,619**	**$ 4,379**

During the third quarter of 2006, S&T Bank issued $25.0 million of junior subordinated debentures through a pooled transaction at an initial fixed rate of 6.78 percent. On September 15, 2011 and quarterly thereafter, S&T Bank has the option to redeem the subordinated debt, subject to a 30 day written notice and prior approval by the Federal Deposit Insurance Corporation (FDIC). If S&T Bank chooses not to exercise the option for early redemption on September 15, 2011 or subsequent quarters, the subordinated debt will convert to a variable rate of 3-month LIBOR plus 160 basis points. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on December 15, 2036.

During the first quarter of 2008, S&T completed a private placement to a financial institution of $20.0 million of floating rate trust preferred securities. The trust preferred securities mature in March 2038, are callable at S&T s option after five years, bear interest initially at a rate of 6.44 percent per annum and quarterly adjust with the three-month LIBOR plus 350 basis points. S&T began making interest payments to the trustee on June 15, 2008 and quarterly thereafter. The trust preferred securities qualify as Tier 1 capital under regulatory guidelines. To issue these trust preferred securities, S&T formed STBA Capital Trust of $0.6 million. S&T owns 100 percent of the common

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

equity. The proceeds from the sale of the trust preferred securities and the issuance of common equity was invested in junior subordinated debt, which is the sole asset of the Trust. The Trust pays dividends on the trust preferred securities at the same rate as the distribution paid by S&T on the junior subordinate debt held by the Trust. Since the third-party investors are the primary beneficiaries, the Trust qualifies as a VIE but is not consolidated in S&T s financial statements.

During the second quarter of 2008, S&T Bank issued $20.0 million of junior subordinated debt through a private placement with three financial institutions at an initial rate of 6.40 percent and floats quarterly with 3-month LIBOR plus 350 basis points. If all or any portion of the subordinated debt ceases to be deemed Tier 2 Capital due to a change in applicable capital regulations, S&T will have the right to redeem, on any interest payment date, subject to a 30 day written notice and prior approval by the FDIC, the subordinated debt at the applicable redemption rate, which starts at a high of 102.82 percent at June 15, 2009 and decreases yearly to 100 percent on June 15, 2013 and thereafter and can be called after five years. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on June 15, 2018.

Also during the second quarter of 2008, S&T Bank issued $25.0 million of junior subordinated debt through a private placement with a financial institution at an initial rate of 5.15 percent and floats quarterly with 3-month LIBOR plus 250 basis points. At any time after May 30, 2013, S&T will have the right to redeem all or a portion of the subordinated debt, subject to a 30-day written notice and prior approval by the FDIC. The subordinated debt qualifies as Tier 2 capital under regulatory guidelines and will mature on May 30, 2018.

NOTE 15. DIVIDEND AND LOAN RESTRICTIONS

S&T is a legal entity separate and distinct from its banking and other subsidiaries. A substantial portion of S&T s revenues consist of dividend payments it receives from S&T Bank. S&T Bank, in turn, is subject to state laws and regulations that limit the amount of dividends it can pay to S&T. In addition, both S&T and S&T Bank are subject to various general regulatory policies relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The Federal Reserve Board has indicated that banking organizations should generally pay dividends only if (i) the organization s net income available to common shareholders over the past year has been sufficient to fully fund the dividends and (ii) the prospective rate of earnings retention appears consistent with the organization s capital needs, asset quality and overall financial condition. Thus, under certain circumstances based upon S&T s financial condition, S&T s ability to declare and pay quarterly dividends may require consultation with the Federal Reserve and may be prohibited by applicable Federal Reserve regulations. If S&T were to pay a dividend in contravention of Federal Reserve regulations, the Federal Reserve could raise supervisory concerns. In addition, prior to January 16, 2012, unless S&T has redeemed the Series A Preferred Stock or the U.S. Treasury has transferred the Series A Preferred Stock to a third party, the consent of the U.S. Treasury is required for S&T to increase its common stock dividend (above the dividend amount prior to the participation in the CPP) or repurchase its common stock or other equity or capital securities, other than in connection with benefit plans consistent with past practice and certain other circumstances.

Federal law prohibits S&T from borrowing from S&T Bank unless such loans are collateralized by specific obligations. Further, such loans are limited to 10 percent of S&T Bank s capital and additional paid-in capital, as defined. S&T currently has a $5.0 million line of credit with S&T Bank secured by investments of another subsidiary of S&T.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 16. COMMITMENTS AND CONTINGENCIES

Commitments

The following table sets forth the commitments and letters of credit for the periods stated:

(in thousands)	2010	2009
Commitments to extend credit	$ 836,042	$ 966,903
Standby letters of credit	135,489	156,293
Total	**$ 971,531**	**$ 1,123,196**

Estimates of the fair value of these off-balance sheet items were not made because of the short-term nature of these arrangements and the credit standing of the counterparties.

S&T s allowance for lending-related commitments totaled $2.7 million at December 31, 2010 and $4.2 million at December 31, 2009. Refer to Note 1 Summary of Significant Accounting Policies, Allowance for Unfunded Commitments for the methodology used to calculate the allowance for unfunded commitments.

S&T has future commitments with third party vendors for data processing and communication charges. Data processing and communication charges related to these commitments resulted in expense of $6.8 million, $6.7 million and $6.0 million in 2010, 2009 and 2008, respectively.

The following table sets forth the future estimated payments related to data processing and communication charges for the periods stated:

(in thousands)	Total
2011	$ 6,828
2012	6,982
2013	6,210
2014	6,386
2015	6,489

Litigation

S&T, in the normal course of business, is subject to various legal and administrative proceedings and claims. While any type of litigation contains a level of uncertainty, S&T believes that the outcome of such proceedings or claims pending will not have a material adverse effect on its consolidated financial position.

NOTE 17. INCOME TAXES

Income tax (benefits) expense for the years ended December 31 are comprised of:

(in thousands)	2010	2009	2008
Current	$ 18,969	$ 3,596	$ 30,540
Deferred	(4,537)	(7,465)	(6,023)
Total	**$ 14,432**	**$ (3,869)**	**$ 24,517**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The statutory to effective tax rate reconciliation for the years ended December 31 is as follows:

	2010	2009	2008
Statutory tax rate	35.0%	35.0%	35.0%
Tax-exempt interest	(4.8)%	(74.2)%	(3.3)%
Dividend exclusion	(0.7)%	(14.4)%	(0.4)%
Bank owned life insurance	(1.3)%	(15.6)%	(0.7)%
Low income housing and federal historic tax credits	(3.9)%	(36.5)%	(1.3)%
Adjustment of deferred balances		6.3%	
Other	0.6%	4.7%	(0.4)%
Effective Tax Rate	**24.9%**	**(94.7)%**	**28.9%**

The provision for income taxes differs from the amount computed by applying the statutory federal income tax rate to income before income taxes. S&T ordinarily generates an annual effective tax rate that is less that the statutory rate of 35 percent primarily due to benefits resulting from tax-exempt interest, excludable dividend income, tax-exempt interest and tax benefits associated with low income housing tax credits from certain partnership investments.

Income taxes applicable to security gains (losses) were $0.1 million in 2010, ($1.8) million in 2009 and ($0.6) million in 2008.

Significant components of S&T s temporary differences were as follows at December 31:

(in thousands)	2010	2009
Deferred Tax Liabilities:		
Net unrealized holding gains on securities available-for-sale	$ (2,818)	$ (2,670)
Prepaid pension	(3,930)	(4,702)
Deferred loan income	(599)	(228)
Purchase accounting adjustments	(3,959)	(5,654)
Depreciation on premises and equipment	(2,001)	(1,900)
Other	(649)	(943)
Total Deferred Tax liabilities	**(13,956)**	**(16,097)**
Deferred Tax Assets:		
Allowance for loan losses	$ 17,644	$ 16,376
Loan fees	341	737
Other employee benefits	2,024	2,574
Low income housing impairment	2,281	1,483
Net adjustment to funded status of pension	6,228	6,016
Impairment of securities	2,130	2,688
Delinquent interest on nonaccrual loans	1,939	2,156
State net operating loss carryforwards	971	784
Other	2,955	1,051
Gross Deferred Tax Assets	**36,513**	**33,865**
Less:		
Valuation allowance for state net operating loss carryforwards	(971)	(784)
Total Deferred Tax Assets	**35,542**	**33,081**

Net Deferred Tax Asset	**$ 21,586**	**$ 16,984**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

S&T establishes a valuation allowance when it is more likely than not that S&T will not be able to realize the benefit of the deferred tax assets. Except for State net operating loss (NOL) carryforwards, S&T has determined that no valuation allowance is necessary for the deferred tax assets because it is more likely than not that these assets will be realized through carryback of taxable income to prior years, future reversals of existing temporary differences and through future taxable income. Periodically, the valuation allowance is reviewed and adjusted based on management s assessments of realizable deferred tax assets. Gross deferred tax assets were reduced by a valuation allowance related to state income tax net operating losses generated by the bank holding company, as utilization of these losses is not likely. These operating loss carryforwards total $9.7 million and will expire in the years 2020-2030.

The period change in deferred taxes can be summarized as follows for the years ended December 31:

(in thousands)	2010	2009
Deferred tax changes reflected in other comprehensive loss	$ (65)	$ 4,185
Deferred tax changes reflected in federal income tax (benefit)	(4,537)	(7,442)

Unrecognized Tax Benefits

A reconciliation of the change in unrecognized tax benefits (UBT) for the year ended December 31:

(in thousands)	2010 Federal and State Gross UTB s	2009 Federal and State Gross UTB s	2008 Federal and State Gross UTB s
Balance at January 1	$ 286	$ 195	$ 246
Prior period tax positions			
Increase			
Decrease	(67)	(79)	(275)
Current period tax positions	23	170	339
Reductions for statute of limitations expirations			(115)
Balance at December 31	**$ 242**	**$ 286**	**$ 195**
Amount That Would Affect the Effective Tax Rate if Recognized	**$ 239**	**$ 249**	**$ 106**

S&T classifies interest and penalties as an element of tax expense. The amount of tax-related interest and penalties recognized in the Consolidated Statements of Income for years 2010, 2009 and 2008 and the total of such amounts accrued in the Consolidated Balance Sheets at December 31, 2010 and 2009 were not material.

S&T monitors changes in tax statutes and regulations to determine if significant changes will occur over the next 12 months. As of December 31, 2010 no significant changes to unrecognized tax benefits are projected, however, tax audit examinations are possible.

NOTE 18. EMPLOYEE BENEFITS

S&T Bank maintains a defined benefit pension plan (the Plan) covering substantially all employees hired prior to January 1, 2008. The benefits are based on years of service and the employee s

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

compensation for the highest five consecutive years in the last ten years. Contributions are intended to provide for benefits attributed to employee service to date and for those benefits expected to be earned in the future.

The following table summarizes the activity in the benefit obligation and Plan assets deriving the funded status, which is recorded in other liabilities in the Consolidated Balance Sheets:

(in thousands)	**2010**	**2009**
Change in Projected Benefit Obligation		
Projected benefit obligation at beginning of year	$ 65,183	$ 62,011
Service cost	2,245	2,311
Interest cost	4,017	3,797
Plan participants contributions	162	342
Actuarial loss	5,373	52
Benefits paid	(2,862)	(3,330)
Projected Benefit Obligation at End of Year	**$ 74,118**	**$ 65,183**
Change in Plan Assets		
Estimated fair value of plan assets at beginning of year	$ 62,480	$ 54,918
Actual return on plan assets	8,994	10,550
Plan participants contributions	162	342
Benefits paid	(2,862)	(3,330)
Estimated Fair Value of Plan Assets at End of Year	**$ 68,774**	**$ 62,480**
Funded Status	**$ (5,344)**	**$ (2,703)**

The following table sets forth the amounts recognized in accumulated other comprehensive loss at December 31:

(in thousands)	**2010**	**2009**
Prior service credit	$ (73)	$ (80)
Net actuarial loss	16,645	16,208
Total (Before Tax Effects)	**$ 16,572**	**$ 16,128**

Below are the actuarial weighted-average assumptions used determining the benefit obligation:

	2010	**2009**
Discount rate	5.75%	6.25%
Rate of compensation increase	4.00%	4.00%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table summarizes the components of net periodic pension cost and other changes in Plan assets and benefit obligation recognized in other comprehensive loss for the years ended December 31:

(in thousands)	2010	2009	2008
Components of Net Periodic Pension Cost			
Service cost benefits earned during the period	$ 2,245	$ 2,311	$ 2,069
Interest cost on projected benefit obligation	4,017	3,797	3,429
Expected return on plan assets	(4,882)	(4,288)	(5,396)
Amortization of prior service credit	(7)	(7)	(7)
Recognized net actuarial loss	824	1,297	
Net Periodic Pension Cost	**$ 2,197**	**$ 3,110**	**$ 95**
Other Changes in Plan Assets and Benefit Obligation Recognized in Other Comprehensive Loss			
Net actuarial loss (gain)	$ 1,261	$ (6,211)	$ 20,156
Recognized actuarial loss	(824)	(1,297)	
Prior service credit			(196)
Recognized prior service credit	7	7	7
Total (Before Tax Effects)	**$ 444**	**$ (7,501)**	**$ 19,967**
Total Recognized in Net Benefit Cost and Other Comprehensive Loss (Before Tax Effects)	**$ 2,641**	**$ (4,391)**	**$ 20,062**

The following table summarizes the actuarial weighted-average assumptions used in determining net periodic pension cost:

	2010	2009	2008
Discount rate	6.25%	6.25%	6.25%
Rate of compensation increase	4.00%	4.00%	4.00%
Expected return on assets	8.00%	8.00%	8.00%

The net actuarial loss included in accumulated other comprehensive loss expected to be recognized in net periodic pension cost during the year ended December 31, 2011 is $0.7 million. The prior service cost expected to be recognized during the same period is not significant.

The accumulated benefit obligation for the Plan was $65.7 million at December 31, 2010 and $57.4 million at December 31, 2009.

S&T considers many factors when setting the assumed rate of return on Plan assets. As a general guideline the assumed rate of return is equal to the weighted-average of the expected returns for each asset category and is estimated based on historical returns as well as expected future returns. The weighted-average discount rate is derived from Corporate yield curves.

S&T Bank s Retirement Plan Committee determines the investment policy for the Plan. In general, the targeted asset allocation is 50 percent to 70 percent equities and 30 percent to 50 percent fixed-income. A strategic allocation within each asset class is employed based on the Plan s time horizon, risk tolerances, performance expectations and asset class preferences. Investment managers have discretion to invest in any equity or fixed-income asset class, subject to the securities guidelines of the Plan s Investment Policy Statement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

During 2010 and 2009, S&T made no contributions to its pension plan and no contributions are required to be made in 2011 at this time.

The following table provides information regarding estimated future benefit payments to be paid in each of the next five years and in the aggregate for the five years thereafter:

(in thousands)	**Amount**
2011	$ 3,140
2012	3,343
2013	3,542
2014	3,741
2015	4,035
2016 2020	23,831

S&T also has supplemental executive retirement plans (SERP) for certain key employees. The SERP plans are unfunded. The balances of the actuarial present values of projected benefit obligations and accrued pension cost related to the SERP were $2.3 million at December 31, 2010 and 2009. Net periodic pension cost related to the SERP was $0.3 million, $0.3 million and $0.4 million for the years ended December 31, 2010, 2009 and 2008, respectively. In accordance with accounting pronouncements, $1.3 million and $1.1 million before tax was reflected in accumulated other comprehensive loss at December 31, 2010 and 2009 in relation to the SERP. The actuarial assumptions used for the SERP are the same as those used for the Plan.

S&T maintains a Thrift Plan, a qualified defined contribution plan, in which substantially all employees are eligible to participate. S&T makes matching contributions to the Thrift Plan up to 3.5 percent of participants eligible compensation and may make additional profit-sharing contributions as provided by the Thrift Plan. Expense related to these contributions amounted to $1.1 million, $1.4 million and $2.0 million in 2010, 2009 and 2008, respectively.

Estimated Fair Value Measurements

The following tables present S&T s pension plan assets measured at estimated fair value on a recurring basis by fair value hierarchy level at December 31, 2010 and 2009. There were no transfers between Level 1 and Level 2 for items of a recurring basis during the periods presented.

		December 31, 2010		
Asset Class[(1)] *(in thousands)*	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents[(2)]	$	$ 3,196	$	$ 3,196
Fixed Income[(3)]	24,302			24,302
Equities:				
Equity index mutual funds domestic[(4)]	1,477			1,477
Equity index mutual funds international[(5)]	3,643			3,643
Domestic Individual Equities[(6)]	34,621			34,621
International Individual Equities[(7)]	1,535			1,535
Total Assets at Estimated Fair Value	**$ 65,578**	**$ 3,196**	**$**	**$ 68,774**

(1) *Refer to Note 1 Summary of Significant Accounting Policies, Fair Value Measurements for a description of levels within the estimated fair value hierarchy.*
(2) *This asset class includes FDIC insured money market instruments.*
(3) *This asset class includes a variety of fixed income mutual funds which primarily invest in investment grade rated securities. Manager(s) have discretion to invest in fixed income related securities including futures, options, and other derivatives. Investments may be made in currencies other than the U.S. dollar.*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

(4) *The sole investment within this asset class is S&P 600 index iShares.*
(5) *The sole investment within this asset class is MSCI EAFE Index iShares.*
(6) *This asset class includes individual domestic equities invested in an active all-cap strategy. It may also include convertible bonds.*
(7) *This asset class includes American Depository Receipts (ADRs).*

	December 31, 2009			
Asset Class[1] *(in thousands)*	**Level 1**	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents[2]	$ 128	$ 5,088	$	$ 5,216
Fixed Income[3]	26,218			26,218
Equities:				
Equity index mutual funds domestic[4]	18,472			18,472
Equity index mutual funds international[5]	4,284			4,284
Domestic Individual Equities[6]	7,720			7,720
International Individual Equities[7]	570			570
Total Assets at Estimated Fair Value	**$ 57,392**	**$ 5,088**	**$**	**$ 62,480**

(1) *Refer to Note 1 Summary of Significant Accounting Policies, Fair Value Measurements for a description of levels within the estimated fair value hierarchy.*
(2) *This asset class includes FDIC insured money market instruments.*
(3) *This asset class includes a variety of fixed income mutual funds which primarily invest in investment grade rated securities. Manager(s) have discretion to invest in fixed income related securities including futures, options, and other derivatives. Investments may be made in currencies other than the U.S. dollar.*
(4) *This asset class includes S&P 400, S&P 500 and S&P 600 index iShares.*
(5) *This asset class includes MSCI EAFE Index iShares.*
(6) *This asset class includes individual domestic equities invested in an active all-cap strategy. It may also include convertible bonds.*
(7) *This asset class includes American Depository Receipts (ADRs).*

NOTE 19. INCENTIVE AND RESTRICTED STOCK PLAN AND DIVIDEND REINVESTMENT PLAN

S&T adopted an Incentive Stock Plan in 1992 (1992 Stock Plan) that provided for granting incentive stock options, nonstatutory stock options, restricted stock and appreciation rights. On October 17, 1994, the 1992 Stock Plan was amended to include outside directors. The 1992 Stock Plan had a maximum of 3,200,000 shares of S&T common stock and expires ten years from the date of board approval. At December 31, 2002, 3,180,822 nonstatutory stock options and restricted stock had been granted under the 1992 Stock Plan. No further awards will be made under the 1992 Stock Plan.

S&T adopted the 2003 Stock Plan in 2003 that provides for granting incentive stock options, nonstatutory stock options, restricted stock and appreciation rights. The 2003 Stock Plan has a maximum of 1,500,000 shares of S&T common stock and expires ten years from the date of board approval. The 2003 Stock Plan is similar to the 1992 Stock Plan, which the 2003 Stock Plan replaced.

Stock Options

As of December 31, 2010, 937,500 nonstatutory stock options have been granted under the 2003 Stock Plan. All of the outstanding nonstatutory stock options are currently exercisable. Nonstatutory stock options granted in 2006 and 2005 are fully vested and have a ten-year life. S&T s policy is to issue shares from treasury upon exercise of stock options. S&T recognized compensation expense of $(0.1) million for the year ending December 31, 2010 and $0.5 million for both years ending December 31, 2009 and 2008. The net of tax effect for December 31, 2010, was $(0.07) million and $0.3 million for both years ending December 31, 2009 and 2008. The $(0.1) million of expense was related to forfeitures of 11,000 shares in 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The estimated fair value of option awards under the nonstatutory stock option plan is estimated on the date of grant using the Black-Scholes valuation methodology, which is dependent upon certain assumptions, as summarized in the following table. S&T uses the simplified method in developing the estimated life of the option, whereby the expected life is presumed to be the mid point between the vesting date and the end of the contractual term. There were no nonstatutory stock options granted in 2010, 2009 or 2008.

The following table summarizes activity for nonstatutory stock options for the years ending December 31:

	2010			2009			2008		
	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Outstanding at Beginning of Year	1,100,550	$ 31.85		1,199,650	$ 31.14		1,489,900	$ 30.17	
Granted									
Exercised	(82,100)	19.81		(1,150)	23.80		(287,050)	26.06	
Forfeited	(87,750)	33.04		(97,950)	23.28		(3,200)	35.47	
Outstanding at End of Year	**930,700**	**32.80**	**3.3 years**	**1,100,550**	**31.85**	**4.1 years**	**1,199,650**	**31.14**	**4.8 years**
Exercisable at End of Year	**930,700**	**$ 32.80**	**3.3 years**	**1,048,925**	**$ 31.55**	**4.0 years**	**1,096,400**	**$ 30.51**	**4.6 years**

The aggregate intrinsic value of options outstanding and exercisable was zero as of December 31, 2010, 2009 and 2008. The aggregate intrinsic value represents the total pretax intrinsic value (the difference between S&T s closing stock price on the last trading day of the fourth quarter and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2010.

The following table provides information about non-vested options for the year ended December 31:

	Non-Vested Options	Weighted Average Grant Date Estimated Fair Value
Non-vested at December 31, 2007	**154,875**	**$ 9.48**
Granted		
Vested	51,625	9.48
Forfeited		
Non-vested at December 31, 2008	**103,250**	**$ 9.48**
Granted		
Vested	51,625	9.48
Forfeited		
Non-vested at December 31, 2009	**51,625**	**$ 9.48**
Granted		
Vested	30,625	9.48
Forfeited	21,000	9.48
Non-vested at December 31, 2010		**$**

As of December 31, 2010, compensation cost related to non-vested, nonstatutory stock options was fully recognized as compensation expense. The remaining options vested on January 1, 2010.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table presents information about stock options exercised for the year ended December 31:

(in thousands)	2010	2009	2008
Number of options exercised	82,100	1,150	287,050
Total intrinsic value of options exercised	$ 131	$ 13	$ 2,787
Cash received from options exercised	1,758	40	10,267
Tax deduction realized from options exercised	46	4	1,004

Restricted Stock

As of December 31, 2010, 90,067 restricted awards have been granted under the 2003 Stock Plan. S&T periodically issues restricted stock to employees and directors, pursuant to the 2003 Stock Plan.

During 2010, 2009 and 2008 S&T granted 14,208, 17,200 and 7,787 restricted shares of common stock, respectively, to outside directors. These shares fully vest one year after the date of grant.

Also during 2010 and 2008 S&T granted 4,688 and 3,224 restricted shares of common stock, respectively, to senior management. No restricted shares were granted in 2009. The awards to senior management were granted in accordance with performance levels set by the Compensation Committee. These shares vest 25 percent per year over a four year vesting period beginning on January 1 one year after the shares were granted.

During the vesting period, the recipient receives dividends and has the right to vote. Generally, if the recipient leaves S&T before the end of the vesting period, the shares will be forfeited. Compensation expense for the restricted stock is ratably recognized over the period of service, generally the vesting period, based on the fair value of the stock on the date of grant.

During 2010, 2009, and 2008, S&T recognized compensation expense of $0.5 million, $0.5 million and $0.4 million and realized a tax benefit of $0.3 million, $0.2 million, and $0.1 million, respectively.

The following table provides information about restricted stock for the year ended December 31:

	Restricted Stock	Weighted Average Grant Date Fair Value
Non-vested at December 31, 2007	**42,960**	**$ 29.38**
Granted	11,011	33.11
Vested	15,080	30.82
Forfeited		
Non-vested at December 31, 2008	**38,891**	**$ 29.88**
Granted	17,200	18,61
Vested	14,749	31.13
Forfeited		
Non-vested at December 31, 2009	**41,342**	**$ 24.75**
Granted	18,896	21.44

Vested	25,006		21.86
Forfeited	3,562		29.15
Non-vested at December 31, 2010	**31,670**	**$**	**24.56**

As of December 31, 2010, there was $0.3 million of total unrecognized compensation cost related to restricted stock that will be recognized as compensation expense over a weighted average period of 0.5 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

Cash Appreciation Rights (CARs)

S&T also sponsors a CARs plan which is accounted for as a liability instrument and required to be marked to market each reporting period. The CARs are settled in cash. There were no CARs granted for the years 2010, 2009 or 2008. 206,900 CARs were granted in 2005 at an exercise price of $37.86 with a four-year vesting period and a ten-year life. During 2010, 5,975 CARs were forfeited. During 2010, 2009 and 2008, S&T recognized compensation expense of $0.1 million, $(0.6) million and $0.4 million pretax and $0.1 million, $(0.4) million and $0.3 million net of tax, respectively. The Black-Scholes option pricing model is used to determine the estimated fair value of the CARs as of each reporting date. The assumptions used to value the CARs for the years ended December 31 were as follows:

	2010	2009	2008
Risk-free interest rate	1.14%	2.12%	1.40%
Volatility of stock	33%	31%	29%
Expected dividend yield	3.00%	3.40%	3.88%
Expected life of options	3.23 years	3.73 years	4.36 years

Dividend Reinvestment Plan

S&T also sponsors a Dividend Reinvestment and Stock Purchase Plan (Dividend Plan) whereby shareholders may purchase shares of S&T common stock at the average fair value with reinvested dividends and voluntary cash contributions. American Stock Transfer and Trust Company, the plan administrator and transfer agent, may purchase shares directly from S&T from shares held in treasury or purchase shares in the open market to fulfill the Dividend Plan s needs.

NOTE 20. PARENT COMPANY CONDENSED FINANCIAL INFORMATION

The following condensed financial statements summarize the financial position of S&T Bancorp, Inc. as of December 31, 2010 and 2009 and the results of its operations and cash flows for each of the three years ended December 31, 2010, 2009 and 2008.

BALANCE SHEETS

	December 31	
(in thousands)	**2010**	**2009**
ASSETS		

Cash	$ 110,889	$ 108,554
Investments in:		
Bank subsidiary	456,468	434,413
Nonbank subsidiaries	17,947	17,284
Other assets	15,010	15,012
Total Assets	**$ 600,314**	**$ 575,263**
LIABILITIES		
Long-term debt	$ 20,619	$ 20,619
Dividends payable	694	694
Other liabilities	336	632
Total Liabilities	**21,649**	**21,945**
Total Shareholders Equity	**578,665**	**553,318**
Total Liabilities and Shareholders Equity	**$ 600,314**	**$ 575,263**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

STATEMENTS OF INCOME

	Years Ended December 31		
(in thousands)	**2010**	**2009**	**2008**
Dividends from subsidiaries	$ 22,634	$ 29,477	$ 87,252
Investment income	86	520	72
Interest expense on long-term debt	782	912	1,038
Other expenses	1,648	1,630	1,249
Income before Equity in Undistributed Net Income of Subsidiaries	**20,290**	**27,455**	**85,037**
Equity in undistributed net income (distribution in excess of net income) of:			
Bank subsidiary	23,158	(15,206)	(21,156)
Nonbank subsidiaries	32	(4,298)	(3,678)
Net Income	**$ 43,480**	**$ 7,951**	**$ 60,203**

STATEMENTS OF CASH FLOWS

	Years Ended December 31		
(in thousands)	**2010**	**2009**	**2008**
OPERATING ACTIVITIES			
Net Income	$ 43,480	$ 7,951	$ 60,203
Equity in (undistributed net income) distribution in excess of net income of subsidiaries	(23,190)	19,504	24,834
Tax benefits from stock-based compensation	(46)	(4)	(1,004)
Other	470	968	1,728
Net Cash Provided by Operating Activities	**20,714**	**28,419**	**85,761**
INVESTING ACTIVITIES			
Net investments in subsidiaries			4,972
Acquisitions			76,970
Net Cash Used In Financing Activities			**(81,942)**
FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt			20,000
Proceeds from issuance of preferred stock and common stock warrant		108,676	
Sale of treasury stock	3,692	1,349	7,480
Preferred stock dividends and amortization of discount	(5,434)	(4,513)	
Cash dividends paid to shareholders	(16,683)	(25,427)	(32,302)
Tax benefits from stock-based compensation	46	4	1,004
Net Cash (Used in) Provided by Financing Activities	**(18,379)**	**80,089**	**(3,818)**
Net increase in cash	2,335	108,508	1
Cash at beginning of year	108,554	46	45
Cash at End of Year	**$ 110,889**	**$ 108,554**	**$ 46**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 21. REGULATORY MATTERS

S&T is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on S&T s financial statements. Under capital guidelines and the regulatory framework for prompt corrective action, S&T must meet specific capital guidelines that involve quantitative measures of S&T s assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. S&T s capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The most recent notifications from the Federal Reserve Bank and the FDIC categorized S&T and S&T Bank, respectively, as well-capitalized under the regulatory framework for corrective action. There have been no conditions or events that management believes have changed S&T or S&T Bank s status during 2010 and 2009.

All bank holding companies and banking subsidiaries are required to have Total capital of at least 8.00 percent of risk-weighted assets, core capital (Tier 1) of at least 4.00 percent of risk-weighted assets and for banking subsidiaries a minimum Tier 1 leverage ratio of 4.00 percent of adjusted quarterly average assets. Tier 1 capital consists principally of shareholders equity including preferred stock; excluding items recorded in accumulated other comprehensive loss, less goodwill and other intangibles. Total capital consists of Tier 1 capital plus junior subordinated debt and the ALL subject to limitation. The regulations also define well-capitalized levels of Total capital, Tier 1 and Tier 1 leverage as 10.00 percent, 6.00 percent and 5.00 percent, respectively.

S&T has $108.7 million of Series A Preferred Stock in its Consolidated Balance Sheets presented as a separate line item in equity. For regulatory purposes, the Series A Preferred Stock issued to the U.S. Treasury, net of the unamortized discount of $2.5 million, is included in Tier 1 capital in accordance with terms of the CPP.

S&T currently has $70.0 million in junior subordinated debt in its Consolidated Balance Sheets and is included in Tier 2 capital in accordance with current regulatory reporting requirements. For regulatory purposes, trust preferred securities totaling $20.6 million, issued by an unconsolidated trust subsidiary of S&T underlying such junior subordinated debt, is included in Tier 1 capital in accordance with current regulatory reporting requirements.

Quantitative measures established by regulation to ensure capital adequacy require S&T to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets and Tier 1 capital to average assets. As of December 31, 2010 and 2009, S&T meets all capital adequacy requirements to which it is subject.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

The following table summarizes risk-based capital amounts and ratios for S&T and S&T Bank.

	Actual		For Capital Adequacy Purposes		To be Well-Capitalized Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2010						
Total Capital (to Risk-Weighted Assets)						
S&T	$ 547,336	16.68%	$ 262,498	8.00%	$ 328,123	10.00%
S&T Bank	405,049	12.42%	260,944	8.00%	326,180	10.00%
Tier 1 Capital (to Risk-Weighted Assets)						
S&T	435,823	13.28%	131,249	4.00%	196,874	6.00%
S&T Bank	294,113	9.02%	130,472	4.00%	195,708	6.00%
Leverage Ratio[(1)]						
S&T	435,823	11.07%	157,513	4.00%	196,891	5.00%
S&T Bank	294,113	7.50%	156,799	4.00%	195,999	5.00%
As of December 31, 2009						
Total Capital (to Risk-Weighted Assets)						
S&T	$ 521,657	15.43%	$ 270,486	8.00%	$ 338,108	10.00%
S&T Bank	382,475	11.39%	268,685	8.00%	335,857	10.00%
Tier 1 Capital (to Risk-Weighted Assets)						
S&T	409,128	12.10%	135,243	4.00%	202,865	6.00%
S&T Bank	270,224	8.05%	134,343	4.00%	201,514	6.00%
Leverage Ratio[(1)]						
S&T	409,128	10.26%	159,502	4.00%	199,378	5.00%
S&T Bank	270,224	6.81%	158,665	4.00%	198,331	5.00%

(1) *Minimum requirement is 3.00 percent for the most highly-rated financial institutions.*

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 22. SEGMENTS

S&T operates in three reportable operating segments: Community Banking, Wealth Management and Insurance.

- The Community Banking segment offers services which include accepting demand deposit accounts, certificates of deposit, and originating commercial and consumer loans, providing letters of credit and credit card services.
- The Wealth Management segment offers discount brokerage services, services as executor and trustee under wills and deeds, guardian and custodian of employee benefits and other trust and brokerage services, as well as a registered investment advisor that manages private investment accounts for individuals and institutions.
- The Insurance segment includes a full-service insurance agency offering commercial property and casualty insurance, group life and health coverage, employee benefit solutions and personal insurance lines.

The following represents total assets by reportable segment as of December 31:

(in thousands)	**2010**	**2009**
Community Banking	$ 4,103,898	$ 4,159,563
Insurance	8,461	8,702
Wealth Management	1,980	2,210
Total Assets	**$ 4,114,339**	**$ 4,170,475**

The following tables provide financial information for these three segments of S&T. The information provided under the caption Eliminations represents operations not considered to be reportable segments and/or general operating expenses and eliminations and adjustments, which are necessary for purposes of reconciling to the Consolidated Financial Statements.

	For the Year Ended December 31, 2010				
(dollars in thousands)	**Community Banking**	**Wealth Management**	**Insurance**	**Eliminations**	**Consolidated**
Interest income	$ 180,319	$ 471	$ 2	$ (373)	$ 180,419
Interest expense	34,692		293	(412)	34,573
Net interest income	145,627	471	(291)	39	145,846
Provision for loan losses	29,511				29,511
Noninterest income	32,959	7,950	4,968	1,333	47,210
Noninterest expense	82,872	7,525	4,850	4,181	99,428
Depreciation expense	4,163	34	62		4,259
Intangible amortization	1,815	75	56		1,946
Income tax (benefit) expense	17,019	324	(102)	(2,809)	14,432
Net Income (Loss)	**$ 43,206**	**$ 463**	**$ (189)**	**$**	**$ 43,480**

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

	For the Year Ended December 31, 2009				
(in thousands)	Community Banking	Wealth Management	Insurance	Eliminations	Consolidated
Interest income	$ 194,978	$ 530	$ 1	$ (422)	$ 195,087
Interest expense	49,283		291	(469)	49,105
Net interest income	145,695	530	(290)	47	145,982
Provision for loan losses	72,354				72,354
Noninterest income	25,905	7,557	4,580	538	38,580
Noninterest expense	86,638	6,378	4,700	3,806	101,522
Depreciation expense	4,199	37	60		4,296
Intangible amortization	2,162	84	62		2,308
Income tax (benefit) expense	(1,076)	615	(187)	(3,221)	(3,869)
Net Income (Loss)	**$ 7,323**	**$ 973**	**$ (345)**	**$**	**$ 7,951**

	For the Year Ended December 31, 2008				
(in thousands)	Community Banking	Wealth Management	Insurance	Eliminations	Consolidated
Interest income	$ 216,026	$ 413	$ 2	$ (323)	$ 216,118
Interest expense	72,299		283	(411)	72,171
Net interest income	143,727	413	(281)	88	143,947
Provision for loan losses	12,878				12,878
Noninterest income	25,056	8,003	5,065	(672)	37,452
Noninterest expense	66,735	5,416	4,872	1,746	78,769
Depreciation expense	3,885	28	64		3,977
Intangible amortization	979	34	42		1,055
Income tax expense (benefit)	25,829	1,086	(68)	(2,330)	24,517
Net Income (Loss)	**$ 58,477**	**$ 1,852**	**$ (126)**	**$**	**$ 60,203**

NOTE 23. NONINTEREST EXPENSE

Noninterest expenses are presented in the table below:

	Years Ended December 31		
(in thousands)	2010	2009	2008
Other operating expenses:			
Unfunded loan commitments	$ (1,555)	$ 2,888	$ 1,025
Loan collection fees	1,770	1,325	261
Professional consulting	2,441	1,897	1,374
Other real estate owned	1,921	759	(294)
Marketing	2,794	2,751	3,180
Other	13,534	10,579	10,677

Total Other Operating Expenses	**$ 20,905**	**$ 20,199**	**$ 16,223**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS continued

NOTE 24. SELECTED FINANCIAL DATA

The following table presents selected financial data for the most recent eight quarters:

(unaudited)

	2010				2009			
(in thousands, except per share data)	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
SUMMARY OF OPERATIONS								
Interest income	$ 44,210	$ 45,325	$ 45,561	$ 45,324	$ 47,126	$ 48,310	$ 49,226	$ 50,424
Interest expense	7,876	8,352	8,936	9,410	10,671	11,477	12,677	14,279
Provision for loan losses	7,676	8,278	9,127	4,430	10,399	8,382	32,184	21,389
Net interest income after provision for loan losses	28,658	28,695	27,498	31,484	26,056	28,451	4,365	14,756
Security gains (losses), net	11	6	103	153	(487)	(2,059)	(1,296)	(1,246)
Noninterest income	11,991	12,329	11,426	11,190	11,370	10,283	11,753	10,262
Noninterest expense	27,018	24,948	25,735	27,930	25,088	24,839	32,762	25,438
Income (loss) before taxes	13,642	16,082	13,292	14,897	11,851	11,836	(17,940)	(1,666)
Provision (benefit) for income taxes	3,352	3,600	3,888	3,593	2,660	2,578	(9,284)	176
Net income (loss)	10,290	12,482	9,404	11,304	9,191	9,258	(8,656)	(1,842)
Preferred stock dividends and amortization of discount	1,553	1,551	1,549	1,547	1,545	1,543	1,541	1,283
Net Income (Loss) Available to Common Shareholders	**$ 8,737**	**$ 10,931**	**$ 7,855**	**$ 9,757**	**$ 7,646**	**$ 7,715**	**$ (10,197)**	**$ (3,125)**
Per Share Data								
Common earnings per share diluted	$ 0.31	$ 0.39	$ 0.28	$ 0.35	$ 0.28	$ 0.28	$ (0.37)	$ (0.11)
Dividends declared	0.15	0.15	0.15	0.15	0.00*(1)*	0.15	0.15	0.31
Common book value	16.91	16.83	16.55	16.39	16.14	15.77	15.48	16.01

(1) S&T s Board of Directors (the Board) approved a change in timing of the declaration and payment of dividends to provide better alignment with quarterly earnings beginning in the fourth quarter 2009. The Board declared a $0.15 per common share cash dividend at its meeting held January 18, 2010. The dividend is payable February 25, 2010 to common shareholders of record on February 1, 2010.

During February of 2011, S&T became aware of a loan modification on a participation loan that occurred in the second quarter of 2010 that had not been properly recorded. S&T elected to record the adjustment in the fourth quarter of 2010 based on the results of a materiality analysis that was performed. As a result, net income reported above for the fourth quarter of 2010 includes a $2.7 million or $0.10 per share, out of period adjustment. Net income for the full year 2010 is properly reported. Management has determined that as of December 31, 2010, there was a control deficiency that constituted a material weakness around the approval and recording of loan charge-offs. Refer to Item 9A Controls and Procedures for Management s Report on Internal Control over Financial Reporting.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

S&T Bancorp, Inc. and subsidiaries:

We have audited S&T Bancorp, Inc. and subsidiaries (the Company) internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management s Report on Internal Control Over Financial Reporting* (Item 9A(b)). Our responsibility is to express an opinion on the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis. A material weakness has been identified and included in management s assessment related to approving and recording loan charge-offs. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the three-year period ended December 31, 2010. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2010 consolidated financial statements, and this report does not affect our report dated March 15, 2011, which expressed an unqualified opinion on those consolidated financial statements.

In our opinion, because of the effect of the aforementioned material weakness on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ KPMG LLP

Pittsburgh, Pennsylvania

March 15, 2011

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

S&T Bancorp, Inc. and subsidiaries:

We have audited the accompanying consolidated balance sheets of S&T Bancorp, Inc. and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of income, changes in shareholders equity and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of S&T Bancorp, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 15, 2011 expressed an adverse opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ KPMG LLP

Pittsburgh, Pennsylvania

March 15, 2011

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None

Item 9A. CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures

Under the supervision and with the participation of S&T s Chief Executive Officer (CEO) and Chief Financial Officer (CFO) (its principal executive officer and principal financial officer, respectively), management has evaluated the effectiveness of the design and operation of S&T s disclosure controls and procedures as of December 31, 2010. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods required by the Securities and Exchange Commission, or the SEC, and that such information is accumulated and communicated to the Company s management, including our CEO and CFO as appropriate, to allow timely decisions regarding required disclosure.

Based on and as of the date of such evaluation, our CEO and CFO concluded that the design and operation of our disclosure controls and procedures were not effective due to a material weakness in the Company s internal controls over financial reporting, as described below.

b) Management s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, (as defined in Exchange Act Rule 13a-15(f)). Our internal control over financial reporting is a process designed by or under the supervision of, our CEO and CFO to provide reasonable assurance to our management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the effectiveness of specific controls or internal control over financial reporting overall to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

As of December 31, 2010, management including the CEO and CFO, assessed the effectiveness of the Company s internal control over financial reporting based on the criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Based upon this assessment, management determined that, as of December 31, 2010, the control deficiency described in the following paragraph constituted a material weakness. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that

Item 9A. CONTROLS AND PROCEDURES continued

there is a reasonable possibility that a material misstatement of the company s annual or interim financial statements will not be prevented or detected on a timely basis.

As of December 31, 2010, we did not maintain effective controls over the approval and recording of loan charge-offs. S&T s processes, procedures and controls related to the recording of loan charge-offs on a timely basis were not operating effectively to ensure that the loan portfolio was appropriately valued and that amounts recorded for the provision for loan losses and related disclosures were accurate.

As a result of this material weakness, we concluded that S&T did not maintain effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control Integrated Framework issued by COSO.

KPMG LLP, our independent registered public accounting firm, has issued an adverse opinion on the effectiveness of S&T s internal control over financial reporting as of December 31, 2010, which is included herein.

c) Plan for Remediation of Material Weakness that Existed as of December 31, 2010

Management is committed to continuing efforts to improve the design and operation of our internal controls, including taking all necessary steps to remediate the material weakness identified above. We will continue to actively remediate this material weakness by assigning additional dedicated and experienced resources with the responsibility of monitoring nonperforming loans and related charge-offs. Our internal task force is in the initial planning phase of our material weakness remediation efforts. The task force is currently redesigning our internal process of reviewing and analyzing loan information that may result in a loan charge-off in order to allow for timely recognition of loan charge-offs. As our management and task force continue to evaluate the material weakness, we expect to initiate additional actions, as appropriate, to remediate the material weakness and develop and implement additional processes necessary to strengthen our internal control over financial reporting.

d) Changes in Internal Control Over Financial Reporting

Other than the material weakness which was identified as a result of an error that occurred during the quarter ended June 30, 2010, there have been no other changes in S&T s internal control over financial reporting that occurred during the quarter ended December 31, 2010 that have materially affected, or are reasonably likely to materially affect, S&T s internal control over financial reporting.

Item 9B. OTHER INFORMATION

None

PART III

Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 of Form 10-K is incorporated herein from the sections entitled Section 16(a) Beneficial Ownership Reporting Compliance , Election of Directors , Executive Officers of the Registrant and Corporate Governance and Board and Committee Meetings in our proxy statement relating to our April 26, 2011, annual meeting of shareholders.

Item 11. EXECUTIVE COMPENSATION

This information required by Item 11 of Form 10-K is incorporated herein from the sections entitled Compensation Discussion and Analysis; Executive Compensation; Director Compensation; Compensation Committee Interlocks and Insider Participation ; and Compensation Committee Report in our proxy statement relating to our April 26, 2011, annual meeting of shareholders.

Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Except as set forth below, the information required by Item 12 of Form 10-K is incorporated from the sections entitled Principal Beneficial Owners of S&T Common Stock and Beneficial Ownership of S&T Common Stock by Directors and Officers in our proxy statement relating to our April 26, 2011, annual meeting of shareholders.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of December 31, 2010 related to the equity compensation plans in effect at that time.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plan (excluding securities

			reflected in column (a))
Equity compensation plan approved by shareholders[1]	930,700	$ 32.80	472,433
Equity compensation plans not approved by shareholders			
Total	**930,700**	**$ 32.80**	**472,433**

(1) *Awards granted under the S&T Bancorp, Inc. Amended and Restated 1992 Incentive Stock Plan (the 1992 Plan) and the 2003 Incentive Stock Plan. The 1992 Plan expired in 2002 and no further awards may be granted thereunder.*

Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 of Form 10-K is incorporated herein from the sections entitled Related Person Transactions and Director Independence in our proxy statement relating to our April 26, 2011, annual meeting of shareholders.

Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by Item 14 of Form 10-K is incorporated herein from the section entitled Independent Registered Public Accounting Firm in our proxy statement relating to our April 26, 2011, annual meeting of shareholders.

PART IV

Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report.

Consolidated Financial Statements: The following consolidated financial statements are included in Part II, Item 8 of this report. No financial statement schedules are being filed since the required information is inapplicable or is presented in the Consolidated Financial Statements or related notes.

(b) Exhibits

3.1	Articles of Incorporation of S&T Bancorp, Inc. Filed as Exhibit B to Registration Statement (No. 2-83565) on Form S-4 of S&T Bancorp, Inc., dated May 5, 1983, and incorporated herein by reference.
3.2	Amendment to Articles of Incorporation of S&T Bancorp, Inc. Filed as Exhibit 3.2 to Form S-4 Registration Statement (No. 33-02600) dated January 15, 1986, and incorporated herein by reference.
3.3	Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective May 8, 1989, incorporated herein by reference. Filed as exhibit 3.3 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated herein by reference.
3.4	Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective July 21, 1995. Filed as exhibit 3.4 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated here by reference.
3.5	Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective June 18, 1998. Filed as exhibit 3.5 to S&T Bancorp, Inc. Annual Report on Form 10-K for year ending December 31, 1998 and incorporated herein by reference.
3.6	Amendment to Articles of Incorporation of S&T Bancorp, Inc. effective April 21, 2008. Filed as Exhibit 3.1 to S&T Bancorp, Inc. Quarterly Report on Form 10-Q filed on August 7, 2008 and incorporated herein by reference.
3.7	Certificate of Designations for the Series A Preferred Stock. Filed as Exhibit 3.1 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 15, 2009 and incorporated herein by reference.
3.8	By-laws of S&T Bancorp, Inc., as amended, April 21, 2008. Filed as Exhibit 3.2 to S&T Bancorp, Inc. Quarterly Report on Form 10-Q filed on August 7, 2008 and incorporated herein by reference.
10.1	S&T Bancorp, Inc. Amended and Restated 1992 Incentive Stock Plan. Filed as Exhibit 4.2 to Form S-8 Registration Statement (No. 333-48549) dated March 24, 1998 and incorporated herein by reference.*
10.2	S&T Bancorp, Inc. 2003 Incentive Stock Plan. Filed as Exhibit 4.2 to Form S-8 Registration Statement (No. 333-111557) dated December 24, 2003 and incorporated herein by reference.*
10.3	Agreement and Plan of Merger, dated as of December 16, 2007, between S&T Bancorp, Inc. and IBT Bancorp, Inc. Filed as exhibit 2.1 to S&T Bancorp, Inc. Current Report on Form 8-K filed on December 17, 2007 and incorporated herein by reference.
10.4	S&T Bancorp, Inc. Thrift Plan for Employees of S&T Bank, as amended and restated. Filed as Exhibit 4.2 to Form S-8 Registration Statement (No. 333-156541) dated December 31, 2008 and incorporated herein by reference.*
10.5	Dividend Reinvestment and Stock Purchase Plan of S&T Bancorp, Inc. Filed as Exhibit 4.2 to Form S-3 Registration Statement (No. 333-156555) dated January 2, 2009 and incorporated herein by reference. Filed as Exhibit 4.2 to S&T Bancorp, Inc. on Form S-8 filed on January 2, 2009 and incorporated herein by reference.*

(b) Exhibits

10.6	Severance Agreement, by and between Todd D. Brice and S&T Bancorp, Inc., dated December 31, 2008. Filed as Exhibit 10.1 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 2, 2009 and incorporated herein by reference.*
10.7	Severance Agreement, by and between Robert E. Rout and S&T Bancorp, Inc., dated December 31, 2008. Filed as Exhibit 10.2 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 2, 2009 and incorporated herein by reference.*
10.8	Severance Agreement, by and between Edward C. Hauck and S&T Bancorp, Inc., dated December 31, 2008. Filed as Exhibit 10.3 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 2, 2009 and incorporated herein by reference.*
10.9	Severance Agreement, by and between David G. Antolik and S&T Bancorp, Inc. dated December 31, 2008. Filed as Exhibit 10.4 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 2, 2009 and incorporated herein by reference.*
10.10	Severance Agreement, by and between Gregor T. Young IV and S&T Bancorp, Inc. dated December 31, 2008. Filed as Exhibit 10.5 to S&T Bancorp, Inc. Current Report on Form 8-K filed on January 2, 2009 and incorporated herein by reference.*
10.11	Severance Agreement, by and between Mark Kochvar and S&T Bancorp, Inc. dated as of January 1, 2009. Filed as Exhibit 10.1 to S&T Bancorp, Inc. Current Report on Form 8-K filed on February 26, 2010 and incorporated herein by reference.*
21	Subsidiaries of the Registrant.
23	Consent of KPMG LLP, Independent Registered Public Accounting Firm.
24	Power of Attorney.
31.1	Rule 13a-14(a) Certification of the Chief Executive Officer.
31.2	Rule 13a-14(a) Certification of the Principal Financial Officer.
32	Rule 13a-14(b) Certification of the Chief Executive Officer and Principal Financial Officer.
99.1	Certification of Chief Executive Officer Pursuant to 31 C.F.R 30.15.
99.2	Certification of Principal Financial Officer Pursuant to 31 C.F.R 30.15.

* Management Contract or Compensatory Plan or Arrangement

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

S&T BANCORP, INC.

(Registrant)

Todd D. Brice	03/15/11 Date
President and Chief Executive Officer	
(Principal Executive Officer)	
Mark Kochvar	03/15/11 Date
Senior Executive Vice President, Chief Financial Officer	
(Principal Financial Officer)	

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
Todd D. Brice	President and Chief Executive Officer (Principal Executive Officer)	03/15/11
Mark Kochvar		
	Senior Executive Vice President and Chief Financial Officer (Principal Financial Officer)	03/15/11
*	Director	03/15/11
John N. Brenzia		
	Director	03/15/11
Thomas A. Brice		
*	Chief Executive Officer and Director (Principal Executive Officer)	03/15/11
Todd D. Brice		
	Director	03/15/11

John J. Delaney

SIGNATURE	TITLE	DATE
*	Director	03/15/11
Michael J. Donnelly		
*	Director	03/15/11
William J. Gatti		
*	Director	03/15/11
Jeffrey D. Grube		
*	Director	03/15/11
Frank W. Jones		
*	Director	03/15/11
David L. Krieger		
*	Director	03/15/11
James V. Milano		
	Chairman of the Board and Director	03/15/11
James C. Miller		
*	Director	03/15/11
Alan Papernick		
	Director	03/15/11
Robert Rebich, Jr.		
	Director	03/15/11
Charles A. Spadafora		
	Director	03/15/11
Christine J. Toretti		
*	Director	03/15/11
Charles G. Urtin		
*By: /s/ Joseph A. Kirk	Director	03/15/11
Joseph A. Kirk		
Attorney-in-fact		

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