

# Huffy Corporation

NYSE: HUF - \$6.53

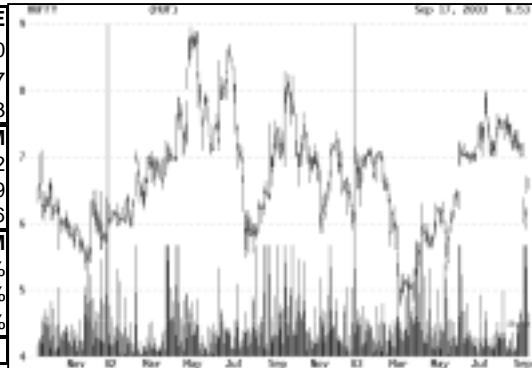
[www.huffy.com](http://www.huffy.com)

Richard J. Wayman, CFA  
rwayman@researchstock.com

## Pre 3Q03 Release Research Notes

### Forecast Reduced Based Upon Slow August Sales

Current Data		EPS (cont. ops)		P/E
Fiscal Year End	Dec	2002	\$ 0.38	17.0
Current Price	\$ 6.53	2003E	\$ 0.39	16.7
52-Week Range	8.95-5.48	2004E	\$ 0.53	12.3
Shares Out (Mill)	14.7	Valuation		LTM
Ave Volume LTM	30,827	P/E (Next FY)	16.74	34-12
Market Cap. (Mill)	\$ 95.86	P/B	1.36	1.7-0.9
LTD/Total Capital	16.0%	Price/Sales	0.21	0.27-0.16
Institutional Hldngs	37.0%	Operating Data		LTM
Insider Holdings	9.3%	Sales Growth	34.4%	46.0%
Book Value	\$ 4.81	Operating Margin	-0.4%	1.7%
10Yr Bond	4.18%	Net Inc. Growth	-316.7%	136.9%



Source: Baseline

#### Key Investment Points

- Lower than expected sales for August (key indicator for 3Q sales) caused management to lower guidance.
- Could this be a first sign of weaker than expected consumer strength?
- Guidance for GAAP EPS for FY03 is \$0.44 to \$0.52.
- Reduced our EPS forecast based upon signs of consumer retrenchment
- 12-18 month target price lowered to \$8.00.

#### Company Description

Huffy Corporation ("HUF") designs and manufactures sport products and provides services for retailers. The Company's Consumer Products segment sells bicycles, basketball backboards, backboard support systems, goals and related products through its operating divisions Huffy Bicycle Company and Huffy Sports Company. Gen-X, the company's wholly owned subsidiary, sells golf, hockey, skis, snowboards, and in-line skates and other action sports equipment. The Company's Huffy Service First unit provides retailers with in-store and in-home assembly and repair and in-store display services for a variety of products as well as other in-store display and merchandising services. HUF acquired McCalla on 3/27/02 and Gen-X on 9/19/02. The addition of McCalla added about \$15-\$20 million in sales in 2002 while the acquisition of Gen-X could add sales of \$150 million in 2003.

Note: Please read the important disclosures at the end of this report.

### **The Bottom Line**

HUF's announcement may be another sign of a weaker than expected consumer. Friday's release of disappointing August retail sales seems to support this opinion. With the mortgage re-fi boom over and joblessness high, it is possible that consumers might reduce spending this year, focusing more on the necessities than "nice-ities."

We reduced our EPS forecast and lowered our 12-18 month target price to reflect slower sales growth assumptions in 2003 and 2004. Investors should keep a close watch on how the peers report in the coming months in order to evaluate the potential economic and investment risks.

### **Revised Outlook**

HUF announced that August sales were below expectations, noting weakness in the in-line skates, action sports, backboards, and the opportunity business. The other segments (Bikes, Golf, Hockey and Snow) seemed to be in line with original expectations. Since August is viewed as a good barometer for sales in 3Q, management reduced their guidance for 2003 from sales of \$470-480 million to \$455-460 million (a decline of \$15-20 million) and EPS from continuing operation (excluding the reversal of a legal settlement accrual) from \$0.49-\$0.61 to \$0.34-\$0.40. Our forecast for EPS from continuing operations was \$0.55.

It also appears that HUF expects to reverse an additional \$0.04 to \$0.06 per share from a litigation reserve account during 2H03 (a total of \$0.10 to \$0.12 for the year). This reserve was established in response to litigation related to Washington Inventory Service (a business they sold in 2000). A \$0.06 reversal was recorded in 2Q03.

We lowered our 2003 EPS forecast based upon a revised sales growth outlook. Our new GAAP EPS forecast is \$0.49 (versus our prior \$0.61) and the EPS from continuing operations is \$0.39 versus our prior estimate of \$0.55.

Our 2004 EPS estimate (both GAAP and continuing operations) is now \$0.53 versus our previous \$0.68 and is based upon:

Sales growth of 5.0% (the low end of the expected range of 5-7%),

Gross margin of 21% (the lower end of our previously assumed range), and

Lowered the assumed effective tax rate to 28% versus our previous 34% assumption to reflect the longer than expected benefit of the timing differences between expenses that have been reflected on the income statement and their deductibility for tax purposes).

Table 1 contains the details of the revised annual model and Table 2 contains the quarterly forecast. See our 2Q03 report (dated August 15, 2003) for more information the model's assumptions.

<b>Table 1: Operating Forecast</b>								
(\$ Million, except per share)	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003e</b>	<b>2004e</b>
Revenues	481.5	584.2	422.9	488.2	331.1	372.9	<b>455.1</b>	<b>477.9</b>
Cost of Goods Sold	407.5	392.2	386.1	406.8	291.2	306.5	<b>357.7</b>	<b>376.3</b>
Gross Profit	74.0	76.2	36.7	81.3	40.0	66.3	<b>97.4</b>	<b>101.5</b>
SG&A	61.8	59.7	56.2	53.8	47.6	57.9	<b>84.5</b>	<b>86.4</b>
Plant Reconfig	0.0	21.3	38.6	0.7	3.7	0.0	<b>0.0</b>	<b>0.0</b>
Operating Income	12.2	-4.9	-58.0	26.9	-11.4	8.5	<b>12.8</b>	<b>15.1</b>
Int Expense-Net (Inc)	0.5	2.5	1.8	8.6	1.8	2.0	<b>4.8</b>	<b>3.6</b>
Non-recurring						0		
Other Expenses/(inc.)	1.4	0.0	0.3	1.3	0.3	1.6	<b>0.7</b>	<b>0.4</b>
PreTax Income	10.3	-7.4	-60.1	17.1	-12.8	5.2	<b>7.3</b>	<b>11.2</b>
Income Taxes	2.7	-2.9	-20.8	6.4	-4.4	0.6	<b>1.5</b>	<b>3.1</b>
Discont. Ops	1.4	2.3	6.1	24.3	0.0	-6.0	<b>1.6</b>	<b>0.0</b>
Net Income	9.0	-2.2	-33.3	35.0	-8.4	-1.4	<b>7.4</b>	<b>8.0</b>
<b>EPS-Diluted (as reported)</b>	<b>\$ 0.69</b>	<b>\$ (0.18)</b>	<b>\$ (3.13)</b>	<b>\$ 3.39</b>	<b>\$ (0.82)</b>	<b>\$ (0.03)</b>	<b>\$ 0.49</b>	<b>\$ 0.53</b>
- Continuing operations				<b>\$ 1.03</b>	<b>\$ (0.82)</b>	<b>\$ 0.38</b>	<b>\$ 0.39</b>	<b>\$ 0.53</b>
Diluted Shares	13.1	12.3	10.6	10.3	10.3	12.0	<b>14.9</b>	<b>15.1</b>
Effective Tax Rate	26%	39%	35%	38%	34%	11%	<b>20%</b>	<b>28%</b>
	<b>Boldface data are forecasts.</b>							
<b>Growth Rates</b>								
Sales	-2.7%	21.3%	-27.6%	15.4%	-32.2%	12.6%	<b>22.0%</b>	<b>5.0%</b>
Net Income	#DIV/0!	-124.2%	-1437.6%	205.1%	-124.0%	83.6%	<b>636.3%</b>	<b>8.8%</b>
EPS- FAS 142 equivalent					-179.0%	146.9%		
<b>Margin Analysis</b>								
Gross	15.4%	13.0%	8.7%	16.7%	12.1%	17.8%	<b>21.4%</b>	<b>21.3%</b>
SGA/Sales	12.8%	10.2%	13.3%	11.0%	14.4%	15.5%	<b>18.6%</b>	<b>18.1%</b>
Operating	2.5%	-0.8%	-13.7%	5.5%	-3.4%	2.3%	<b>2.8%</b>	<b>3.2%</b>
Net	1.9%	-0.4%	-7.9%	7.2%	-2.5%	-0.4%	<b>1.6%</b>	<b>1.7%</b>

<b>Table 2: Quarterly Operating Forecast</b>								
(\$ Million, except per share)	<b>Mar-02</b>	<b>Jun-02</b>	<b>9/02</b>	<b>12/02</b>	<b>Mar-03</b>	<b>Jun-03</b>	<b>9/03</b>	<b>12/03</b>
Revenues	70.39	93.41	83.03	126.07	94.63	117.48	<b>113.00</b>	<b>130.00</b>
Cost of Goods Sold	58.38	76.38	67.07	104.71	74.74	92.13	<b>88.76</b>	<b>102.12</b>
Gross Profit	12.00	17.03	15.96	21.36	19.89	25.35	<b>24.24</b>	<b>27.89</b>
SG&A	10.53	13.85	12.83	20.66	20.30	21.63	<b>21.60</b>	<b>21.00</b>
Plant Reconfig	0.00	0.00	0.00	0.00	0.00	0.00	<b>0.00</b>	<b>0.00</b>
Operating Income	1.47	3.18	3.13	0.70	-0.41	3.72	<b>2.64</b>	<b>6.89</b>
Interest Expense/ (Inc.)	0.30	0.32	0.29	0.78	1.11	1.28	<b>1.20</b>	<b>1.25</b>
Other Expenses/ (Inc.)	0.20	0.76	0.42	0.25	0.17	0.17	<b>0.16</b>	<b>0.20</b>
PreTax Income	0.97	2.10	2.42	-0.33	-1.69	2.27	<b>1.28</b>	<b>5.44</b>
Income Taxes	0.34	0.83	0.75	-1.35	-0.34	0.45	<b>0.26</b>	<b>1.09</b>
Net Income-Cont. Ops	0.62	1.28	1.67	1.02	-1.35	1.81	<b>1.02</b>	<b>4.35</b>
Discont. Ops.	0.00	0.00	-0.72	-5.25	0.00	0.96	<b>0.30</b>	<b>0.30</b>
Net Income	0.62	1.28	0.95	-4.22	-1.35	2.77	<b>1.32</b>	<b>4.65</b>
EPS-Diluted	\$ 0.06	\$ 0.12	\$ 0.08	\$ (0.29)	\$ (0.09)	\$ 0.18	<b>\$ 0.09</b>	<b>\$ 0.31</b>
FAS 142 equivalent	\$ 0.06	\$ 0.12	\$ 0.08	\$ (0.29)	\$ (0.09)	\$ 0.18	<b>\$ 0.09</b>	<b>\$ 0.31</b>
Diluted Shares	10.618	10.736	12.128	14.788	14.68	15.112	<b>15</b>	<b>15</b>
Effective Tax Rate	35%	39%	31%	412%	20%	20%	<b>20%</b>	<b>20%</b>
Boldfaced data are estimates.								
<b>Growth Rates</b>								
Sales	-13.4%	7.5%	6.5%	48.2%	34.4%	25.8%	<b>36.1%</b>	<b>3.1%</b>
Operating Income	-7.5%	222.3%	-190.1%	110.4%	128.0%	-16.8%	<b>15.7%</b>	<b>-879.4%</b>
Net Income	62.8%	166.0%	-33.8%	42.7%	316.7%	-117.3%	<b>-39.8%</b>	<b>210.1%</b>
EPS (FAS 142)	-46.6%	48.4%	-130.7%	58.8%	256.7%	-54.4%	<b>-13.1%</b>	<b>208.5%</b>
<b>Margin Analysis</b>								
Gross	17.1%	18.2%	19.2%	16.9%	21.0%	21.6%	<b>21.5%</b>	<b>21.5%</b>
EBITDAR	2.1%	3.4%	3.8%	0.6%	-0.4%	3.2%	<b>2.3%</b>	<b>5.3%</b>
Operating	2.1%	3.4%	3.8%	0.6%	-0.4%	3.2%	<b>2.3%</b>	<b>5.3%</b>
Net	0.9%	1.4%	1.1%	-3.3%	-1.4%	2.4%	<b>1.2%</b>	<b>3.6%</b>

## Valuation

We lowered our 12-18 month target price to \$8.00 from \$8.90 (see Table 3) based upon our revised EPS forecast. We will pay extra close attention to the upcoming Warnings Season and economic releases in order to determine the duration of this potential weakness in consumer discretionary spending. The valuation metrics for the peer group are shown in Table 4.

	Multiples		Forecast	2003 Est.**	Target Range	Mult. F'cast	2004 Est.**	Target Range	
	LTM Range	Current*							
<b>Price/Book</b>	High	1.4	1.4	1.6	\$ 7.14	\$ 11.43	1.6	\$ 7.67	\$ 12.28
	Low	0.9		1.0		\$ 7.14	1.0		\$ 7.67
<b>Price/Sales</b>	High	0.29	0.23	0.40	\$ 30.45	\$ 12.18	0.30	\$ 31.55	\$ 9.46
	Low	0.17		0.17		\$ 5.18	0.17		\$ 5.36
<b>P/E*</b>	High	-10.5	12.3	15.0	\$ 0.39	\$ 5.85	15.0	\$ 0.53	\$ 7.96
	Low	-191.7		8.0		\$ 3.12	8.0		\$ 4.25
* Current P/E is based on 2003 EPS forecast									
** Continuing operations				Average	High	\$ 9.82	Average	High	\$ 9.90
					Low	\$ 5.15		Low	\$ 5.76
					Average	\$ 7.48		Average	\$ 7.83

	Price	P/E		Price to			Sales/Share	Ent Val/EBITDA
		2002	2003	Book	CF	Sales		
<b>HUF</b>	\$6.53	<b>16.7</b>	<b>11.9</b>	<b>1.4</b>	<b>13.1</b>	<b>0.23</b>	<b>\$28.63</b>	<b>16.8</b>
Leisure Industry	\$16.96	6.2	0.9	3.0	11.8	0.97	\$31.70	9.2
Peer group	\$16.32	1.1	15.3	1.6	11.3	0.70	\$21.41	8.6
<b>Golf</b>	\$8.92	1.0	14.7	1.3	8.6	0.90	\$8.87	5.4
Sport. Goods Retlrs	\$26.22	1.4	14.4	2.7	11.9	0.73	\$39.35	8.7
<b>Peer Group</b>								
<b>ALDA</b>	\$2.55	-	-	0.5	-	0.35	\$7.19	-
<b>ELY</b>	\$15.28	1.0	14.7	2.0	8.6	1.45	\$10.54	5.4
VFLX	\$6.30	-	-	0.9	12.1	0.48	\$13.03	6.9
ESCA	\$23.00	-	-	3.2	10.3	0.80	\$28.70	9.3
HED	\$2.47	-	-	0.4	12.4	0.24	\$10.34	10.8
KTO	\$16.83	0.5	18.5	1.5	13.3	0.71	\$23.66	10.3
<b>Sporting Goods Retailers</b>								
TSA	\$32.07	1.9	12.8	1.8	11.4	0.74	\$43.08	9.4
GLYN	\$11.26	0.7	11.5	0.9	6.2	0.30	\$36.96	5.5
GRTS	\$28.98	-	-	-	-	-	-	-
HIBB	\$24.44	1.1	18.8	3.5	16.4	1.27	\$19.19	11
DKS	\$34.34	2.0	14.6	4.4	13.7	0.59	\$58.18	9

Source: Baseline

## Peer Group Comparison

HUF's trailing 12 month operating performance is just starting to show the benefits of the Gen-X acquisition. It's a difficult market, but HUF's diversified product line and brand names should give it a competitive advantage. The following tables compare HUF's trailing 12-month operating performance and valuation metrics to the peers and industry composites.

	Sales		Margins			% Change		Assets/ Equity	TIE	Operat. %	
	\$	Growth	Gross	EBIDTA	Net	EPS	Change			cashflow	Change
<b>HUF</b>	\$ 421.2	29%	21%	2.6%	0.7%	\$0.24	192%	312%	1.7	-55.8	-172.0%
Leisure Industry	\$ 677.7	7%	36%	2.5%	0.7%	\$0.71	35%	311%	15.7	148.0	-10.2%
Golf	\$ 416.0	-3%	37%	2.4%	1%	\$ 0.41	21%	40%	74.7	145.3	45.0%
Peer group	\$ 350.6	11%	33%	11%	2%	\$ 0.56	70%	334%	29.2	148.0	-10.2%
<b>Peer Group</b>											
ALDA	\$ 35.6	-4.1%	18%	na	-8.8%	(\$0.45)	21%	55.9%	-	7.2	137.7%
ELY	\$ 796.3	-1.7%	55%	23.8%	9.8%	\$1.27	20%	23%	74.7	283.5	29.2%
VFLX	\$ 60.0	39.3%	18%	5.0%	3.1%	\$0.39	203%	38%	57.5	-0.8	-142.7%
ESCA	\$ 184.7	21.3%	34%	11.8%	5.9%	\$1.65	-6%	373%	10.9	-8.3	-149.7%
HED	\$ 392.6	1.5%	43%	5.1%	-2.2%	(\$0.25)	na	948%	0.3	56.9	-26.0%
KTO	\$ 634.5	9.5%	33%	8.3%	1.6%	\$0.72	112%	568%	2.8	104.2	193.0%

Source: Baseline

## Risk Considerations

In addition to normal investment risk, investors need to consider the following when evaluating an investment in the shares of this stock:

Loss of a Service customer could have an adverse impact on 2004 sales if volume is not replaced. In the 2Q03 10-Q HUF disclosed that its "bid to retain a portion of its current business with a retailer in the home improvement segment was not accepted." While we do not expect this to impact 2003 sales, it could impact 2004 sales if the business is not replaced. The extent of a worst-case scenario (no replacement is found) is difficult to quantify because no additional data was provided. It appears that the potential loss is material enough that Management felt it should be disclosed, but not material (or not yet quantifiable) enough to be more specific. With the pressure on retailers to cut costs, it is possible that HUF could replace the lost business.

The acquisition of Gen-X, combined with a slow economy, resulted in negative operating cash flow and increased leverage during 1Q03. (One of HUF's fundamental strengths has been its ability to generate positive cash flows.) While we think the Gen-X acquisition will be good for the long term, it could cause some near-term concern, as investors get accustomed to the new seasonal working capital flows of the combined company. However, if consumer spending falls, it could have an adverse impact on demand for HUF's products and cause HUF's operating results to fall below our forecast. This could result in continued negative operating cash flows that would adversely impact leverage and solvency ratios.

The shares are thinly traded and could experience significant volatility.

The Company is not widely followed by Wall Street analysts. As a consequence, any improvement in operations may not be reflected in the share price as quickly as it might if the Company was widely followed.

The EPA issue regarding groundwater contamination at a former HUF site appears to have been resolved, with the superfund settlement, which was announced on May 10, 2002. The Company has reserved the estimated amount needed (\$6.93 million), and the costs will have no impact on earnings. The Company continues to seek contribution from other non-signatory potentially responsible parties, although no payback of funds is included in any of our estimates.

The introduction of Schwinn bicycles into the mass marketing retail segment is expected to create strong competition with HUF not only for sales but also for floor space at various retailers. 2002 floor space allocations have already been decided, but there is risk in this area in 2003.

---

**FULL FRONTAL DISCLOSURE** (In plain English)

- We are paid a fixed annual fee by the subject company to provide research, much as a corporation pays a fee to a bond-rating agency for bond research and ratings. We do not accept any form of equity as payment nor a "performance bonus."
- Any "forward looking statements" are our estimates and are based upon information that is publicly available and that we believe to be correct, but we have not independently verified its truthfulness.
- Our forecasts may turn out to be wrong.
- The analysts does not own any shares of the subject company in any form.
- We do not make a market in the shares of the subject company.
- We have not done any investment banking business with the subject company.

---

**(Legalese)**

This report contains "forward looking" statements within the meaning of U.S. federal securities laws. Forward-looking statements regarding the Company's performance inherently involve risks and uncertainties that could cause actual results to differ from such forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of the Company's products/services in the marketplace; acceptance in the marketplace of the Company's new product lines/services; competitive factors; new product/service introductions by others; technological changes; dependence upon third party vendors; and other risks discussed in the Company's periodic report filings, including interim reports, with the Securities and Exchange Commission, By making these forward looking statements, researchstock.com, Inc. undertakes no obligation to update these statements for revisions or changes after the date of this report.

NEITHER RESEARCHSTOCK.COM NOR ANY PROVIDERS OF INFORMATION MAKE ANY WARRANTIES, EXPRESS OR IMPLIED, AS TO RESULTS TO BE OBTAINED FROM USING THIS INFORMATION AND MAKE NO EXPRESS OR IMPLIED WARRANTIES OR FITNESS FOR A PARTICULAR USE.

researchstock.com, Inc. is an independent research firm that publishes research reports on companies that may, or may not be clients. researchstock.com, Inc. derives most of its compensation from investment research and financial advisory services, and has been compensated for the preparation of this report. researchstock.com, Inc.'s compensation consists of a flat monthly fee of \$2,500. researchstock.com does not
------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

accept any form of equity nor does it accept any “performance bonuses”. This information is solely for informative purposes and is not solicitation or an offer to buy or sell any security. It is not intended as being a complete description of the securities, markets or developments referred to in the material. The information contained herein is subject to change without notice, and we assume no responsibility to update the information in this report. Any sales or earnings forecasts contained in this report were independently prepared by researchstock.com, Inc., unless otherwise stated, and are not endorsed by the Management of the company which is the subject of this report. All expressions of opinion are subject to change without notice. The information contained herein was obtained from sources, which we consider reliable, but we have not independently verified such information and thus do not guarantee that it is accurate or complete. Additional information is available upon request. researchstock.com, Inc. and/or its officers and directors, stockholders, and employees, and/or members of their families may have a long/short position in the securities mentioned in this report and may make purchases and or sales for their own account of those securities as principal or agent in the open market or otherwise. This report does not take into account the investment objectives, financial situation or particular needs of any particular person. Investors should obtain individual financial advice based on their own particular circumstances before making investment decisions on the basis of this report.