

# Huffy Corporation

NYSE: HUF - \$5.70

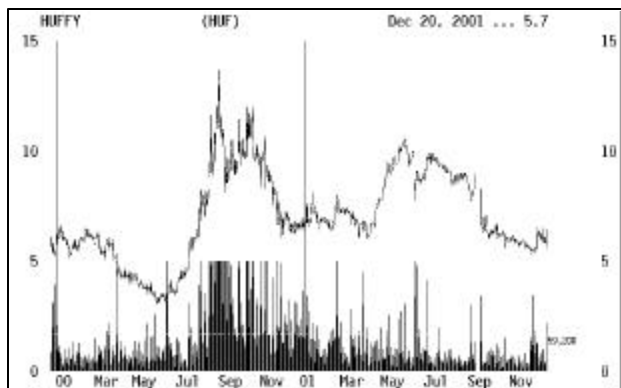
[www.huffy.com](http://www.huffy.com)

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## Restructuring & Inventory Charges Should Improve Future Profitability

Current Data		EPS		P/E
Fiscal Year End	Dec	2000	\$ 1.03	5.5
Current Price	\$ 5.70	2001E	\$ (0.54)	-10.6
52-Week Range	11-5	2002E	\$ 0.23	25.0
Shares Out (Mill)	10.5	<b>Valuation</b>		<b>Current</b>
Ave Volume LTM	36,848	P/E (Next FY)	-10.63	14-3
Market Cap. (Mill)	\$ 59.85	P/B	0.78	1.5-0.7
LTD/Total Capital	0.0%	Price/Sales	0.15	0.28-0.14
Institutional Holdings	40.0%	<b>Operating Data</b>		<b>2Q01</b>
Insider Holdings	9.3%	Sales Growth	-37.1%	-14.3%
Book Value	\$ 7.28	Operating Margin	-4.5%	2.6%
10Yr Bond	5.04%	Net Inc. Growth	157.5%	174.7%

Source: Baseline except for EPS estimates, researchstock.com



Source: Baseline

### Key Investment Points

- 2001 EPS forecast reduced to a loss of \$0.53 from our previous forecast of a loss of \$0.08.
- Moving production from Mexico to Asia (\$2.7 mill.) and corporate restructuring (\$1.2 mill.) will result in \$3.9 million charge.
- Liquidating inventories (scooters) will result in a \$4.3 million charge.
- Corporate restructuring expected to reduced SG&A by \$1.0 million in 2002.
- 4Q01 sales (ex-scooter) are ahead of last year's pace, helped by Micro Monkey Bike sales.
- New Loews deal could add \$10.0 million in 2002 revenues.
- 2002 EPS forecast unchanged and we reiterate our 12-18 month target price of \$7.50.

### Company Description

Huffy Corporation ("HUF") designs and manufactures sport products and provides services for retailers. The Company's Consumer Products segment makes bicycles, basketball backboards, backboard support systems, goals and related products through its wholly-owned subsidiaries: Huffy Bicycle Company and Huffy Sports Company. 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.

## The Bottom Line

While HUF's pre-announcement completes a disappointing year, but it makes 2002 look better, especially considering the recent announcement of the Loews agreement. For the year, HUF expects to lose between \$0.51 and \$0.54 per share versus our forecast of a loss of \$0.02 per share. The approximately \$0.50 per share difference between our forecast and the new guidance (using \$0.52 as the mid point of the new range) is about evenly split between restructuring charges and expected losses on inventory discounting (discussed below).

We are reiterating our 2002 forecast and target price at this time because net of these charges, HUF's results look to be in line with our expectations. While the Loews deal should be additive to our earnings, we have not yet included this in our 2002 forecast as a hedge against a lower than expected Christmas and spring sales.

While all consumer stocks are being hit hard by the current recession, we think HUF will weather the storm better than others for the following reasons:

- **Financial flexibility:** \$14 million (\$1.36 per share) in cash at 3Q01 (estimated \$20 million at year-end) and no debt provide ample cushion to cope with the current cyclical downturn.
- **Growing Market Share and Top Brand Name:** HUF is still one of the top three brands in each of its markets, and has been growing market share.
- **New Product Development:** From lighted balls to poolside backboards, new product development should provide an offset to the current slump in bike sales.
- **Distribution Channels:** Established channels at both ends of the market (discount mass merchants to Internet sales of customized bikes) HUF is well positioned to weather the current recession and benefit from a recovery that is expected late next year.
- **Acquisition Potential:** Management has been clear about exploring all opportunities, including acquisitions and possible sale of the company. The Schwinn bid shows that management has a disciplined approach and will not overpay just to use up cash. Management continues to explore non-bike acquisitions that make economic sense.

Included in "all opportunities" is the chance that HUF may be acquired. Based upon our research, we think a takeover bid could be at a 20% premium to the current stock price.

## Cost Reductions Reduce 2001 Forecast

HUF announced FY01 EPS expectations that were significantly below our forecast due to charges relating to operating restructuring and inventory closeouts. However, these actions should improve operating margins and purge the scooter inventory overhang.

The key question at this point remains how good will Christmas sales be. If retailers have a "decent" Christmas, spring re-orders should keep HUF on track with our forecast. If this is an extremely blue Christmas, re-orders will be delayed for possibly a quarter. Management expects to be able to provide more sales guidance in late January.

Here is a summary of the charges and their impact on EPS:

**Restructuring Charges: \$3.9 million (\$0.24 - \$0.31 per share):**

1. HUF shifted production from a Mexican supplier to Asia in order to take advantage of lower prices. This will result in a \$2.7 million charge, mostly a non-cash equipment write-off.
2. Additional corporate restructuring charge of \$1.2 million. This is another part of the Company's ongoing goal of reducing SG&A by 5%-7% and is expected to save \$1.0 million in 2002.

**Inventory Reduction Charge: \$4.3 million (about \$0.26 per share)**

This charge represents the discounts that will be given to eliminate the inventory overhang that consists largely of scooters. This action will increase margins by eliminating the carrying costs of the merchandise and allows management to focus on more critical issues.

**Loews/Huffy Service First Power Equipment Agreement**

Under this strategic partnership, HSF will provide in-store service for outdoor power equipment at 450 Loews units with the potential to generate \$10 million in additional sales in 2002. If this is successful, Loews will rollout the program to the rest of its units in 2003 (currently Loews has 700+ stores across the US and opening more daily).

This is an intriguing development for two reasons. First, Loews approached HUF to outsource this service because of HUF's nationwide presence, supporting our view that HSF has a definite competitive advantage in this highly fragmented industry. Second, it establishes a precedent that could open the eyes of other nationwide retailers who are also looking for ways to outsource non-core duties, generating more business for HSF.

However, we have not included the potential revenues into our 2002 model at this time. Due to the uncertainties of the Christmas sell-through and the margin impact of the Loews business, we chose to keep our 2002 forecast in the low \$0.20 range.

**Forecast and Valuation**

We reiterate our \$7.50 target price and our 2002 EPS forecast of \$0.22. As noted above, our 2002 forecast is unchanged for two main reasons:

- Core operations appear to be on track to meet our forecasts, and
- While the Loews deal provides upside potential in 2002, the Christmas sell-through remains a key unknown. Our conservative assumption is that the Christmas season will be weaker than expected, but the Loews business will compensate for the shortfall.

Our key assumptions are that sales grow 2% over 2001 and SG&A expenses are relatively flat (cost reductions offset inflationary increases). Table 1 contains our adjusted 2001 and current 2002 forecast and Table 2 contains our valuation methodology.

<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>
Revenues	580.7	584.2	422.9	488.2	<b>346.1</b>	<b>353.0</b>
Cost of Goods Sold	488.6	392.2	386.1	406.8	<b>302.7</b>	<b>305.0</b>
Gross Profit	92.1	76.2	36.7	81.3	<b>43.4</b>	<b>48.0</b>
SG&A	75.7	59.7	56.2	53.8	<b>43.3</b>	<b>43.2</b>
Plant Reconfig	0.0	21.3	38.6	0.7	<b>0.0</b>	<b>0.0</b>
Operating Income	16.4	-4.9	-58.0	26.9	<b>0.1</b>	<b>4.8</b>
Interest Expense/ (Inc.)	3.9	2.5	1.8	8.4	<b>0.9</b>	<b>0.9</b>
Other Income/Expenses	1.0	0.0	0.3	1.3	<b>0.1</b>	<b>0.1</b>
PreTax Income	11.5	-7.4	-60.1	17.1	<b>-9.1</b>	<b>3.8</b>
Income Taxes	3.0	-2.9	-20.8	6.4	<b>-3.5</b>	<b>1.4</b>
Discont. Ops	0.5	2.3	6.1	24.3	0.0	<b>0.0</b>
Net Income	9.0	-2.2	-33.3	35.0	<b>-5.6</b>	<b>2.4</b>
<b>EPS-Diluted (as reported)</b>	\$ 0.69	\$ (0.18)	\$ (3.13)	\$ 3.39	\$ <b>(0.54)</b>	\$ <b>0.23</b>
From on-going operations				\$ 1.03	\$ <b>(0.54)</b>	\$ <b>0.23</b>
Diluted Shares	13.1	12.3	10.6	10.3	<b>10.4</b>	<b>10.4</b>
Effective Tax Rate	26%	39%	35%	38%	<b>39%</b>	<b>38%</b>
<b>Boldface data are forecasts.</b>						
<b>Growth Rates</b>						
Sales	0.2%	0.6%	-27.6%	15.4%	<b>-29.1%</b>	<b>2.0%</b>
Net Income	22.1%	-124.2%	-1437.6%	205.1%	<b>-115.9%</b>	<b>-142.4%</b>
EPS					<b>-151.9%</b>	<b>-142.4%</b>
<b>Margin Analysis</b>						
Gross	15.9%	13.0%	8.7%	16.7%	<b>12.5%</b>	<b>13.6%</b>
Operating	2.8%	-0.8%	-13.7%	5.5%	<b>0.0%</b>	<b>1.4%</b>
Net	1.5%	-0.4%	-7.9%	7.2%	<b>-1.6%</b>	<b>0.7%</b>

<b>Table 2: Target Price Calculations</b>						
Multiples						
		<b>LTM</b>			<b>2002</b>	<b>Target</b>
		<b>Range</b>	<b>Current*</b>	<b>Forecast</b>	<b>Estimate</b>	<b>Range</b>
<b>Price/Book</b>	High	3.3	0.8	2.5	\$ 6.74	\$ 16.84
	Low	0.9		0.9		\$ 6.06
<b>Price/Sales</b>	High	0.29	0.15	0.30	\$ 34.01	\$ 10.20
	Low	0.14		0.16		\$ 5.44
<b>P/E*</b>	High	14.0	11.2	30.0	\$ 0.23	\$ 6.83
	Low	3.0		2.0		\$ 0.46
* Current P/E is based on 2001 EPS forecast						
		Average	High		\$ 11.29	
			Low		\$ 3.99	
			Average		\$ 7.64	

For comparative purposes, Tables 3 and 4 provide valuation and price performance metrics for HUF, Cannondale (BIKE) and leisure time stocks.

	P/E		Price to			Sales/ Share	Ent Val/ EBITDA
	2001	2002	Book	CF	Sales		
<b>HUF</b>	<b>-10.6</b>	<b>25.0</b>	<b>0.8</b>	<b>5.3</b>	<b>0.15</b>	<b>\$37.92</b>	<b>2.6</b>
BIKE	-	-	0.3	-	0.11	\$19.13	8.4
Sector Ave.	21.0	17.5	2.3	24.1	1.24	\$18.24	15.8
Sales>\$500MM	20.8	16.9	3.0	16.7	1.04	\$30.36	22.9

Source: Baseline, researchstock.com

(% Change)	3 Days	1 Wk	1 Mo	6 Mos	YTD	12 Mos.
<b>HUF</b>	<b>-7.9</b>	<b>-8.1</b>	<b>1.1</b>	<b>-34.1</b>	<b>-12.3</b>	<b>-12.3</b>
BIKE	-3.3	-3.8	-2.4	-47.4	-44.4	-43.9
Sector Ave.	0.7	0.4	3.4	-0.8	39.9	44.3
Sales>\$500MM	0.4	2.9	4.6	13.0	44.4	192.9

Source: Baseline, researchstock.com

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