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Huffy Corporation

NYSE: HUF - \$9.35

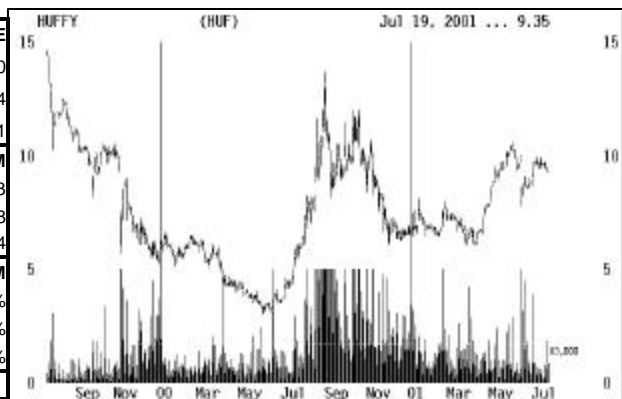
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Despite Slump in Bikes Sales, Margins are Steady; EPS from Continuing Operations Up

Current Data		EPS		P/E
Fiscal Year End	Dec	2000	\$ 1.03	9.0
Current Price	\$ 9.35	2001E	\$ 0.57	16.4
52-Week Range	14-5	2002E	\$ 0.92	10.1
Shares Out (Mill)	10.5	Valuation		Current
Ave Volume LTM	86,782	P/E (Next FY)	16.37	9-3
Market Cap. (Mill)	\$ 98.18	P/B	1.27	1.5-0.8
LTD/Total Capital	0.0%	Price/Sales	0.23	0.25-0.14
Institutional Holdings	37.0%	Operating Data		2Q01
Insider Holdings	9.3%	Sales Growth	-28.8%	7.0%
Book Value	\$ 7.38	Operating Margin	1.1%	5.3%
10Yr Bond	5.11%	Net Inc. Growth	-20.8%	130.9%

Source: Baseline except for EPS estimates, researchstock.com



Source: Baseline

Key Investment Points

- 2Q sales and EPS were better than our revised forecast.
- Despite lower sales, gross margins were stable.
- EPS from continuing operations were \$0.07 versus \$0.06, the high end of management's revised range.
- Positioned to buy Schwinn/GT assets from bankruptcy
- FY guidance maintained at \$0.50-\$0.75. Our forecast is \$0.57
- Our revised 12-18 month target price is \$12.00.

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.

Bottom Line:

Despite the slowdown in retail sales, HUF's revamped business plan is proving its mettle. Despite a sales drop of almost 29%;

- The gross margin remained relatively stable,
- EPS from ongoing operations were better than last year,
- Cash flows remained strong, and
- HUF is still debt free.

This stability in the face of a significant weakness in its core business provides HUF with the flexibility to do things like, say, acquire Schwinn/GT.

The Schwinn/GT acquisition is not a sure thing at this point because others can still bid during Schwinn's bankruptcy proceedings (expected to last 4-8 more weeks). Management did indicate that if its \$60 million offer were successful, the acquisition would be dilutive to EPS during the first six months, but accretive to earnings over the first year. The key benefit of the acquisition is a complimentary brand name that can be leveraged over HUF's distribution channels.

Because 2Q01 results were better than we expected (by \$0.03), we raised our EPS forecast and target price.

2Q01 Results

Sales fell almost 29% mainly due to a weak economy this year. However, despite this adverse environment, HUF's business plan resulted in steady gross margins and an increase in EPS from continuing operations (see Table 1).

	2Q00	2Q01	1H00	1H01	Change	
					2Q	1H
Sales	122	86.9	222.1	168.1	-28.8%	-24.3%
Gross Margin	14.0%	13.9%	14.3%	14.1%	-0.7%	-1.4%
EPS	\$ 0.06	\$ 0.07	\$ (0.05)	\$ 0.17	16.7%	-440.0%

According to management, the weaker economy continued to impact sales of both bikes and Huff Service First, while basketball systems rose 18% from gaining market share. Bike sales have declined as consumers are trading down to lower price points and as retailers minimize inventories (see our June 21, 2001 report for more details).

The sales slump caused the operating margin to decline despite a stable gross margin and lower operating costs. The overall gross margin remained relatively solid as HUF avoided the negative impact of a manufacturer's high fixed-cost structure. We view this as validation of HUF's restructuring effort and the conversion from a bicycle manufacturer to a sporting goods designer and distributor. Although operating costs declined in dollar terms, the sales shortfall caused operating margins to decline to 1.1% from 3.2%. As shown in Table 2, lower interest expense and an increase in other income helped EPS from ongoing operations.

Table 2: 2Q Comparison			
(\$ Million, except per share)	2Q00	2Q01	Change
Revenues	122.03	86.86	-29%
Cost of Goods Sold	104.97	74.79	-29%
Gross Profit	17.06	12.08	-29%
SG&A	11.60	11.09	-4%
Plant Reconfig	1.61	0.00	-100%
Operating Income	3.85	0.99	-74%
Interest Expense/ (Inc.)	2.54	0.09	-97%
Other Expenses/ (Inc.)	-0.12	-0.34	172%
PreTax Income	1.44	1.24	-14%
Income Taxes	0.80	0.47	-41%
Net Income-Cont. Ops	0.64	0.77	21%
Discont. Ops.	3.88	0.00	-100%
Net Income	4.51	0.77	-83%
EPS-Diluted	\$ 0.44	\$ 0.07	-84%
From Cont. ops.	\$ 0.06	\$ 0.07	18%
Diluted Shares	10.265	10.503	2%
Effective Tax Rate	56%	38%	
Margin Analysis			
Gross	14.0%	13.9%	-1%
EBITDAR (excl. reconstructn.)	4.2%	3.7%	-11%
Operating	3.2%	1.1%	-64%
Net-Continuing operations	0.5%	0.9%	70%

Despite the decline in sales, inventory levels seem to have stabilized. As shown below, inventories as a percent of total assets appear to have stabilized...

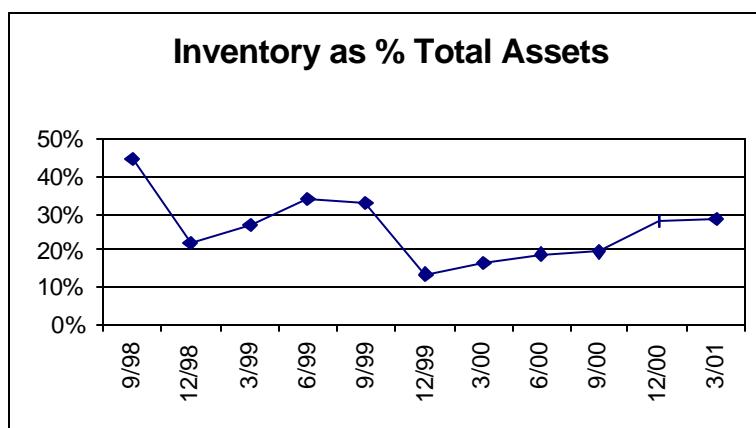


Figure 1

but inventory turnover continues to slow (see Figure 2). However, the Company continues to keep a tight reign on receivable levels (days sales outstanding was relatively flat).

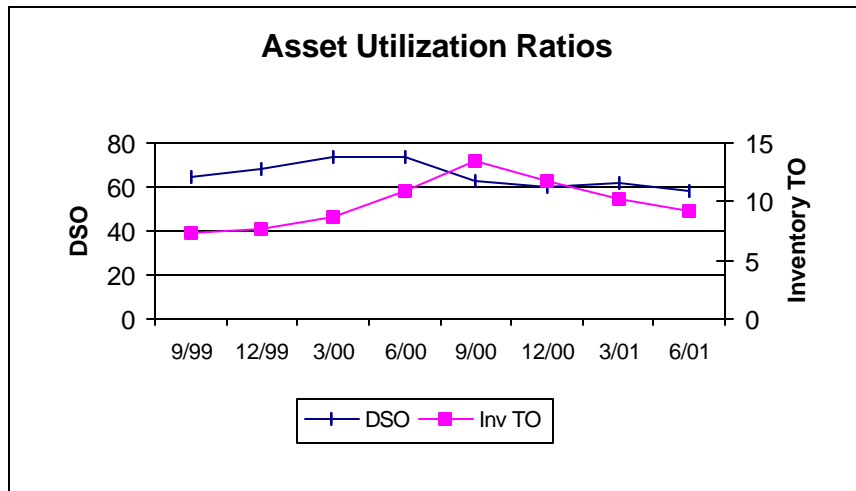


Figure 2

Peer Group Comparison

As shown in Table 3, despite the sales decline, HUF has been able to not only remain profitable but has also posted respectable EPS growth

	Sales		Margins			EPS	% Change
	\$	Growth	Gross	EBIDTA	Net		
HUF	\$560	-21%	18%	7.5%	3.2%	\$ 1.14	168.0%
BIKE	\$148	-9%	32%	6.5%	-12.0%	\$ (0.91)	-810.0%
Sector Ave.	\$496	14%	30%	15.5%	-6.4%	\$ 0.51	-38.5%
Sales>\$500MM	\$1,501	4%	32%	12.4%	3.7%	\$ 1.26	-8.9%

Source: Baseline

Financial Condition

With no debt and almost \$17 million in cash, HUF continues to have a balance sheet that provides flexibility. As long as inventory and receivable levels remain under control, we expect HUF can continue to generate cash flow despite a continued sales slump.

Schwinn/GT Acquisition

HUF signed a definitive agreement to acquire the assets of Schwinn/GT from bankruptcy. However, this is not a done deal because the bankruptcy process allows others to bid on the assets. It will take 4-8 weeks before any deal is finalized.

What we do know is that HUF is offering \$60 million to buy the inventory, receivables, and trade marks of Schwinn/GT. According to Management, the main benefits of the acquisition (leveraging the brand on HUF's channels, inventory sales, and receivable collection) are expected to be accretive by the end of the first 12 months. The key benefit will be the ability of HUF to leverage the Schwinn/GT brand through its distribution system. Schwinn/GT is an upscale product currently sold through independent bicycle dealers ("IBDs"). Possible strategies are to distribute the same high-end product through HUF's high-end channels and/or create a new product with that brand at a lower price point for the mass merchants.

Outlook

We revised our forecast to reflect the better than expected 2Q01 results and lower interest expense. We currently do not assume any impact from the Schwinn/GT announcement because it is currently unknown when, or if, the deal will close. The net result is that we raised our 2001 EPS forecast to \$0.63 from \$0.53. Our 2002 forecast rose to \$0.89 from \$0.87 as the result of including 2Q01 sales in our model and holding SG&A relatively constant. Tables 4 and 5 contain our annual and quarterly forecast models, respectively.

Table 4: Operating Forecast						
(\$ Million, except per share)	1997	1998	1999	2000	2001	2002
Revenues	580.7	584.2	422.9	488.2	358.1	376.0
Cost of Goods Sold	488.6	392.2	386.1	406.8	303.0	315.9
Gross Profit	92.1	76.2	36.7	81.3	55.1	60.2
SG&A	75.7	59.7	56.2	53.8	45.6	44.0
Plant Reconfig	0.0	21.3	38.6	0.7	0.0	0.0
Operating Income	16.4	-4.9	-58.0	26.9	9.5	16.2
Interest Expense/ (Inc.)	3.9	2.5	1.8	8.4	0.8	1.0
Other Income/Expenses	1.0	0.0	0.3	1.3	-1.0	-0.4
PreTax Income	11.5	-7.4	-60.1	17.1	9.6	15.6
Income Taxes	3.0	-2.9	-20.8	6.4	3.7	5.9
Discont. Ops	0.5	2.3	6.1	24.3	0.0	0.0
Net Income	9.0	-2.2	-33.3	35.0	6.0	9.6
EPS-Diluted (as reported)	\$ 0.69	\$ (0.18)	\$ (3.13)	\$ 3.39	\$ 0.57	\$ 0.92
From on-going operations				\$ 1.03	\$ 0.57	\$ 0.92
Diluted Shares	13.1	12.3	10.6	10.3	10.5	10.5
Effective Tax Rate	26%	39%	35%	38%	38%	38%
Boldface data are forecasts.						
Growth Rates						
Sales	0.2%	0.6%	-27.6%	15.4%	-26.6%	5.0%
Net Income	22.1%	-124.2%	-1437.6%	205.1%	-82.9%	61.4%
EPS					-44.8%	61.4%
Margin Analysis						
Gross	15.9%	13.0%	8.7%	16.7%	15.4%	16.0%
Operating	2.8%	-0.8%	-13.7%	5.5%	2.6%	4.3%
Net	1.5%	-0.4%	-7.9%	7.2%	1.7%	2.6%

Table 5: Quarterly Operating Forecast								
(\$ Million, except per share)	1Q00	2Q00	3Q00	4Q00	1Q01	2Q01	3Q01	4Q01
Revenues	100.07	122.03	123.88	142.21	81.24	86.86	90.00	100.00
Cost of Goods Sold	85.31	104.97	102.03	114.53	69.61	74.79	75.60	83.00
Gross Profit	14.76	17.06	21.84	27.68	11.64	12.08	14.40	17.00
SG&A	12.90	11.60	12.54	16.73	10.04	11.09	12.00	12.50
Plant Reconfig	1.72	1.61	-1.82	-0.80	0.00	0.00	0.00	0.00
Operating Income	0.15	3.85	11.12	11.74	1.59	0.99	2.40	4.50
Interest Expense/ (Inc.)	1.97	2.54	2.71	1.21	0.41	0.09	0.20	0.10
Other Expenses/ (Inc.)	-0.01	-0.12	1.36	0.11	-0.42	-0.34	-0.10	-0.10
PreTax Income	-1.81	1.44	7.04	10.42	1.60	1.24	2.30	4.50
Income Taxes	-0.69	0.80	2.18	4.14	0.61	0.47	0.87	1.71
Net Income-Cont. Ops	-1.12	0.64	4.87	6.28	0.99	0.77	1.43	2.79
Discont. Ops.	-0.02	3.88	0.37	20.09	0.00	0.00	0.00	0.00
Net Income	-1.14	4.51	5.24	26.37	0.99	0.77	1.43	2.79
EPS-Diluted	\$ (0.11)	\$ 0.06	\$ 0.47	\$ 2.54	\$ 0.10	\$ 0.07	\$ 0.14	\$ 0.27
From Cont. ops.	\$ (0.11)	\$ 0.06	\$ 0.50	\$ 0.61	\$ 0.10	\$ 0.07	\$ 0.14	\$ 0.27
Diluted Shares	10.165	10.265	10.386	10.4	10.369	10.503	10.503	10.503
Effective Tax Rate	38%	56%	31%	40%	38%	38%	38%	38%
Margin Analysis								
Gross	14.8%	14.0%	17.6%	19.5%	14.3%	13.9%	16.0%	17.0%
EBITDAR	1.9%	4.5%	7.5%	7.7%	2.0%	1.1%	2.7%	4.5%
Operating	0.1%	3.2%	9.0%	8.3%	2.0%	1.1%	2.7%	4.5%
Net	-1.1%	3.7%	4.2%	18.5%	1.2%	0.9%	1.6%	2.8%

Boldfaced data are estimates.

Valuation

We raised our 12-18 month target price to \$12.00 from \$10.00 based upon our revised 2002 forecast (see Table 6). We do expect that there could be more upside potential near-term as the market speculates on the potential impact of the Schwinn/GT acquisition. Based on what we currently understand, if HUF does acquire Schwinn/GT, our forecast would probably rise, which is why we chose a target price nearer to the upper end of the forecast range.

Table 6: Target Price Calculations						
		Multiples			2002	Target
		LTM	Current*	Forecast	Estimate	Range
Price/Book		Range				
	High	3.7	1.3	1.8	\$ 8.48	\$ 15.26
	Low	1.1		0.8		\$ 6.78
Price/Sales	High	0.33	0.22	0.33	\$ 35.92	\$ 11.85
	Low	0.10		0.10		\$ 3.59
P/E*	High	3.1	16.4	20.0	\$ 0.92	\$ 18.43
	Low	-6.8		10.0		\$ 9.22
* Current P/E is based on 2001 EPS forecast						
		Average	High		\$ 15.18	
			Low		\$ 6.53	
		Average			\$ 10.86	

We think these are reasonable valuation assumptions based upon peer group data (see Table 6) and HUF's relative stock performance (Table 7).

	P/E		Price to			Sales/ Share	Ent Val/ EBITDA
	2001	2002	Book	CF	Sales		
HUF	16.4	10.1	1.3	5.5	0.22	\$42.41	2.3
BIKE	-	-	0.5	604.1	0.20	\$19.59	8.6
Sector Ave.	21.5	41.1	2.3	32.6	1.25	\$18.98	19.1
Sales>\$500MM	18.2	67.7	2.9	13.5	1.01	\$33.12	11.1

Source: Baseline, researchstock.com

(% Change)	3 Days	1 Wk	1 Mo	6 Mos	YTD	12 Mos.
HUF	-0.5	-2.6	8.3	27.9	43.8	52.7
BIKE	-0.8	-2.0	-0.3	-30.7	5.8	-39.4
Sector Ave.	0.4	1.5	4.6	28.9	43.8	12.9
Sales>\$500MM	-0.2	2.3	9.3	26.0	37.4	60.6

Source: Baseline, researchstock.com

Risk Considerations

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

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 is a wild card. While the company has reserved an amount it deems adequate, it is possible that the Company could have a higher liability for any number of reasons. The potential liability is discussed in detail in the notes to the financial statements in the SEC filings (10-Qs and 10-Ks).

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