

# Huffy Corporation

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NYSE: HUF - \$7.50

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

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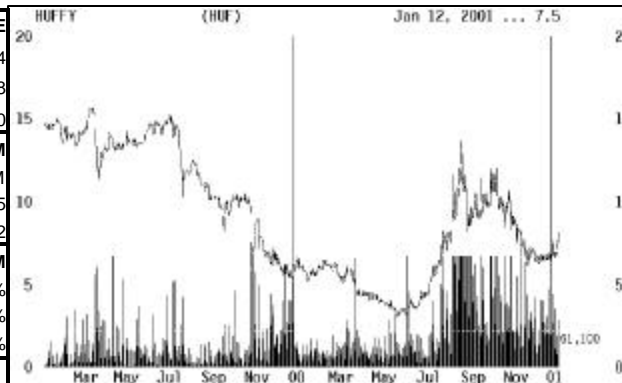
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## 3Q00 Results

### New Product Popularity and Reconfigured Operations Increase Profits

Current Data		EPS		P/E
Fiscal Year End	Dec	1999	\$ (3.13)	-2.4
Current Price	\$ 7.50	2000E (Cont ops)	\$ 1.10	6.8
52-Week Range	14-3	2001E	\$ 1.08	7.0
Shares Out (Mill)	10.2	<b>Valuation</b>		<b>Current</b>
Ave Volume LTM	82,083	P/E (Next FY)	6.81	NM-NM
Market Cap. (Mill)	\$ 76.57	P/B	1.86	2.1-1.5
LTD/Total Capital	2.0%	Price/Sales	0.15	0.15-0.12
Institutional Holdings	34.0%	<b>Operating Data</b>		<b>This Qtr</b>
Insider Holdings	9.3%	Sales Growth	62.2%	-5.6%
Book Value	\$ 4.03	Operating Margin	7.5%	2.7%
10Yr Bond	5.24%	Net Inc. Growth	116.3%	55.6%

Source: Baseline except for EPS estimates, researchstock.com



Source: Baseline

### Key Investment Points

- 3Q Sales rose 62% on the popularity of scooters and X-Games® bicycles.
- Operating income before reconfiguration charges were \$9.3 million in 3Q00 versus a loss of \$12.9 million in 3Q99.
- The sale of Washington Inventory Service (after the close of the quarter) is provided funds to significantly reduce debt levels and add \$1.97 per share in 4Q00.
- 12-18 month target price is \$10.00.

### 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, poles, goals and related products through its wholly-owned subsidiaries: Huffy Bicycle Company and Huffy Sports Company. The Company’s Services For Retail unit provides retailers with in-store and in-home assembly and repair and in-store display services for a variety of products.

## Summary of Reconfiguration Results

From mid-1998 to date, the Company has been eliminating excess production capacity and reducing operating costs by selling a Missouri plant and closing its Celia, Ohio bicycle plant. During the nine-month period in 1999 and 2000, this project resulted in expenses of \$3.5 million and \$1.5 million (this figure includes a \$3.0 million gain from the sale of a Missouri plant), respectively.

During the last two years, HUF sold two operations; True Temper Hardware and Washington Inventory Service.

- In March 1999, HUF sold True Temper for \$100 million (subject to certain post-closing adjustments). The net gain on this sale was \$5.95 million and increased EPS by \$0.55.
- Washington Inventory Service ("WIS") was sold in November 2000 for \$84.7 million cash and is subject to certain post-closing adjustments. The proceeds from this transaction were used to reduce debt and will add \$1.97 to 4Q00 EPS.

## Recent Results: 3Q00

Recent result reflects the positive impact of reconfigured operations and sales growth of 62%. The popularity of HUF's scooters and XGames® bicycles as well improved sales at Huffy Sports drove sales growth. Figures below illustrate the sales trend in dollars (Figure 1) and in percentage growth (Figure 2). It is important to note that the data prior to 1Q99 are not restated for the recent divestitures and thus understates the improving trend.

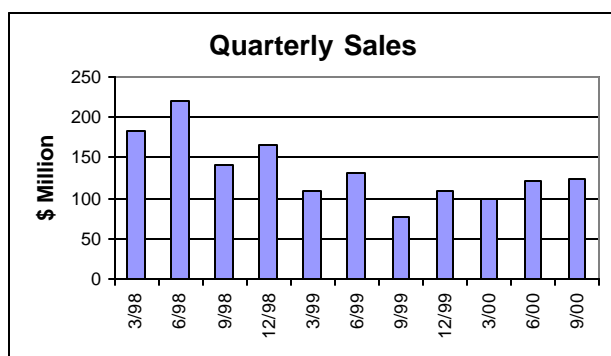


Figure 1

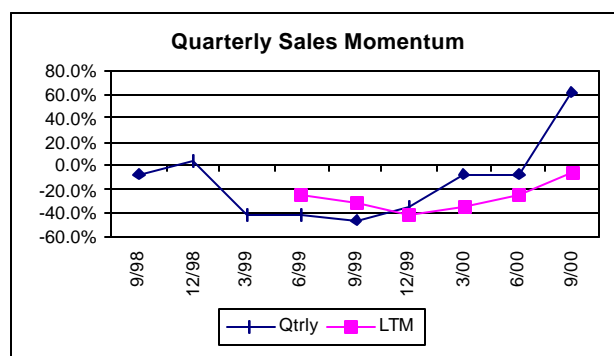


Figure 2

Restructured operations improved operating margins, which increased diluted EPS from continuing operations to \$0.47 from a loss of \$2.94 per share in 3Q99. One-time charges that impacted these results were:

- Bicycle reconfiguration which boosted EPS \$0.11 in 3Q00; and
- A reconfiguration charge that reduced EPS by \$1.95 in 3Q99.

Reported EPS was \$0.50 (\$0.03 per share was from discontinued operations of Washington Inventory Service and early debt retirement) in the current quarter and a loss of \$2.52 in 3Q99 (which included \$0.42 per share earnings from discontinued operations).

The gross margin rose to 17.6% from a negative 2.0% as the result of: cost controls; increased operating efficiencies in bicycle manufacturing; and an improved product mix. 3Q99's gross margin was adversely impacted by a one-time inventory write-down. Offsetting some of this improvement were operating inefficiencies in the assembly service unit and volume driven declines in the basketball backboard business.

Operating income benefited from improved operations and an easy comparison with last year when HUF recorded a \$30.7 million reconfiguration expense (for plant closings, severance, and asset write-downs). SG&A as a percent of sales improved to 10.1% from 18.5% as the result of reconfigured operations and cost controls. Table 1 summarizes and compares the 3Q results.

<b>Table 1: Quarterly Operating Comparison</b>			
(\$ Million, except per share	<b>3Q99</b>	<b>3Q00</b>	<b>Change</b>
Revenues	76.35	123.88	62%
Cost of Goods Sold	77.87	102.03	31%
Gross Profit	-1.52	21.84	1539%
SG&A	14.12	12.54	-11%
Plant Reconfig	30.74	-1.82	-106%
Operating Income	-46.38	11.12	124%
Interest Expense/ (Inc.)	0.13	2.71	2004%
Other Income/Expenses	-0.11	1.36	1329%
PreTax Income	-46.40	7.04	115%
Income Taxes	-16.49	2.18	113%
Net Income	-29.91	4.87	116%
<b>EPS-Diluted</b>	<b>\$ (2.94)</b>	<b>\$ 0.47</b>	na
Diluted Shares	10.157	10.386	2%
Effective Tax Rate	36%	31%	
<b>Margin Analysis</b>			
Gross	-2.0%	17.6%	
Operating	-60.7%	9.0%	
Net	-39.2%	3.9%	

For the nine-month period, the reconfiguration effort and modest sales growth resulted in improved profitability. As shown in Figure 2:

- Sales increased 10% to \$346.0 million;
- The gross margin improved to 15.5% from 10.9% as weaker margins in Huffy Sports sales offset the improvement in other product lines.
- Operating income before reconfiguration charges improved to \$16.6 million from a loss of \$8.0 million in 1999;
- SG&A expenses dropped in dollar terms and were reduced to 10.7% of sales from 13.4% in 1999;

- EBITDA for the nine-month period improved to \$20.8 million from a loss of \$0.6 million in 1999 and amounted to \$2.02 per share; and
- Diluted EPS from continuing operations rose to \$0.43 from a net loss per share of \$2.59 for the same period in 1999.

The last column in Table 2 illustrates how most of the operating improvement occurred during 3Q00.

<b>Table 2: Year to Date Operating Comparison</b>				<b>3Q</b>
(\$ Million, except per share)	<b>YTD 99</b>	<b>YTD 00</b>	<b>Change</b>	<b>Change</b>
Revenues	315.528	345.972	10%	62%
Cost of Goods Sold	281.275	292.305	4%	31%
Gross Profit	34.253	53.667	57%	1539%
SG&A	42.251	37.032	-12%	-11%
Plant Reconfig	33.447	1.511	-95%	-106%
Operating Income	-41.445	15.124	136%	124%
Interest Expense/ (Inc.)	1.375	7.221	425%	2004%
Other Expenses/ (Inc.)	0.135	1.228	-810%	1329%
PreTax Income	-42.955	6.675	116%	115%
Income Taxes	-15.004	2.291	115%	113%
Net Income	-27.951	4.384	116%	116%
<b>EPS-Diluted</b>	<b>\$ (2.59)</b>	<b>\$ 0.43</b>		
Diluted Shares	10.803	10.303		
Effective Tax Rate	35%	34%		
<b>Margin Analysis</b>				
Gross	10.9%	15.5%		
Operating	-13.1%	4.4%		
Net	-8.9%	1.3%		

### Financial Condition

HUF's financial condition improved as the Company was able to substantially reduce debt levels after the sale of WIS, which occurred after the close of the quarter. HUF sold WIS for \$84.7 million and used the funds to repay all long-term debt and reduced short-term loans. The remaining debt consists of working capital credit facilities.

Asset utilization continues to improve. As shown in Figure 3 (next page), DSO and inventory turnover has improved significantly during the last quarter. However, cash flow from operations fell to a negative \$17.3 million from a negative \$0.5 million due to growth in receivables (+30% from December 1999) and inventories (+62% from December 1999), which is not unexpected given the significant rise in sales during the most recent quarter.

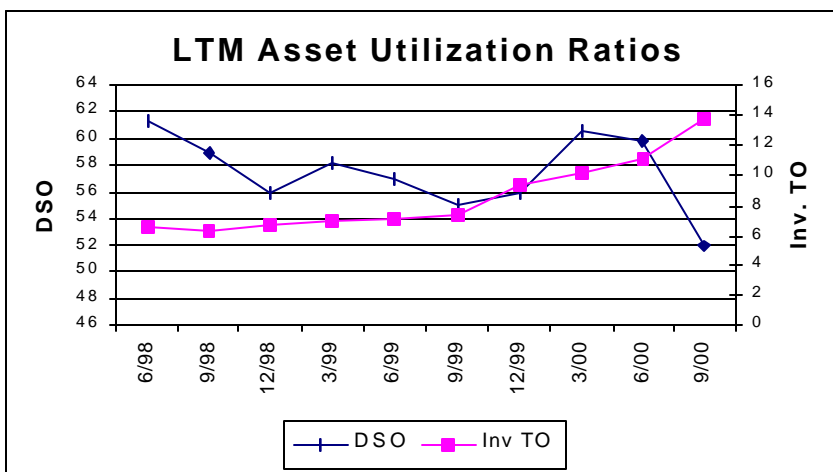


Figure 3

### Outlook

We expect 2000 EPS to be \$3.07, consisting of \$1.10 per share from continuing operations and \$1.97 per share from the sale of WIS. Our EPS from continuing operations is at the low end of the range (\$1.10 to \$1.15 per share) that Management announced in late 2000.

2000 will be a difficult comparison for 2001, but we are optimistic about HUF's future earnings potential for three main reasons:

1. The restructuring is complete and the Company is now a multi-brand design, marketing and distribution company instead of a single-brand manufacturer and marketer of bicycles. We expect operating margins to improve as sales growth is leveraged off a relatively stable and reduced cost structure.
2. Future sales growth is expected from promising new products and increased marketing efforts in under-served markets.
3. Well-positioned as one of the top scooter brands.

Scooters, however, are the big variable. The craze generated a lot of low quality/low price products in the market and it is possible that the Fad may have peaked. How well scooters sell this spring will be a critical factor in determining if the wheels have fallen off this product.

Our EPS forecast for 2001 is \$1.08. We assume that the scooter phenomenon has peaked and that sales will be below 2000 levels, but above 1999's adjusted total (see Figure 4). While the reconfiguration reduced operating costs and interest expense should be significantly lower, increased marketing and a higher effective tax rate (as HUF used all its tax loss carryforwards) are the main causes for lower EPS.

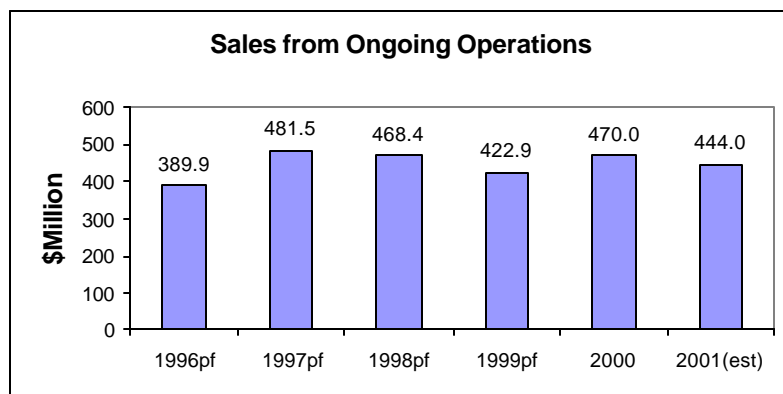


Figure 4

Other key assumptions are:

- Gross margin of 16.4%;
- SG&A expense increases 5% in 2001 (mostly new product introduction);
- Nominal interest expense; and
- An effective tax rate of 38%.

Table 3 contains our annual earnings model.

(\$ Million, except per share)	Not restated for 2000 divestitures			<b>2000</b>	<b>2001</b>
	<b>1997</b>	<b>1998</b>	<b>1999</b>		
Revenues	580.7	584.2	561.0	<b>472.0</b>	<b>440.0</b>
Cost of Goods Sold	488.6	486.7	502.5	<b>395.0</b>	<b>367.8</b>
Gross Profit	92.1	97.5	58.5	<b>77.0</b>	<b>72.2</b>
SG&A	75.7	76.9	73.9	<b>49.5</b>	<b>51.8</b>
Plant Reconfig	0.0	21.3	38.6	<b>1.5</b>	<b>0.0</b>
Operating Income	16.4	-0.7	-53.9	<b>25.9</b>	<b>20.4</b>
Interest Expense/ (Inc.)	3.9	6.5	6.7	<b>7.2</b>	<b>2.3</b>
Other Income/Expenses	1.0	-0.4	-0.7	<b>2.1</b>	<b>0.0</b>
PreTax Income	11.5	-6.8	-60.0	<b>16.6</b>	<b>18.1</b>
Income Taxes	3.0	-2.7	-20.7	<b>6.1</b>	<b>6.9</b>
Discont. Ops	0.5	2.0	5.9	22.2	0.0
Net Income	9.0	-2.2	-33.3	<b>32.7</b>	<b>11.2</b>
<b>EPS-Diluted (as reported)</b>	<b>\$ 0.69</b>	<b>\$ (0.18)</b>	<b>\$ (3.13)</b>	<b>\$ 3.17</b>	<b>\$ 1.08</b>
From on-going operations				<b>\$ 1.10</b>	<b>\$ 1.08</b>
Diluted Shares	13.1	12.3	10.6	<b>10.3</b>	<b>10.4</b>
Effective Tax Rate	26%	39%	35%	<b>37%</b>	<b>38%</b>
				<b>Boldface data are forecasts.</b>	
<b>Growth Rates</b>					
Sales	0.2%	0.6%	-4.0%	-15.9%	-6.8%
Net Income	22.1%	-124.2%	-1437.6%	198.1%	-65.7%
<b>Margin Analysis</b>					
Gross		16.7%	10.4%	16.3%	16.4%
Operating		-0.1%	-9.6%	5.5%	4.6%
Net		-0.4%	-5.9%	6.9%	2.5%

## Valuation Analysis

Our 12 – 18 month target price is \$10.00 and is based on our earnings model and what we feel are conservative valuation multiples. Table 4 shows how we average three valuation techniques (Price/Book, Price/Sales, and P/E) to arrive at our target price.

	<u>Multiples</u>			2001 Estimate	Target Range
	Historic	Current	Forecast		
<b>Price/Book</b>	4.5	1.6	2.0	\$ 5.82	\$ 11.64
	0.7		0.7		\$ 4.08
<b>Price/Sales</b>	0.30	0.10	0.25	\$ 42.75	\$ 10.69
	0.05		0.05		\$ 2.14
<b>P/E</b>		3.6	8.0	\$ 1.13	\$ 9.00
			2.0		\$ 2.25
				Average High	\$ 10.44
				Low	\$ 2.82

To provide a current perspective, Table 5 compares HUF's valuation metrics to the other publicly-traded bike manufacturer an average of the 73 publicly-traded companies that are comprise the Leisure Time Products sector in the Baseline database.

	<u>P/E</u>		P/B	P/CF	P/Sales	Sales/ Share
	2000	2001				
<b>HUF</b>	6.8	7.0	1.9	10.1	0.14	\$ 54.83
<b>BIKE</b>	na	na	0.5	8.4	0.23	\$ 21.45
<b>LSURE</b>	13.9	11.6	1.7	8.9	0.99	\$ 19.13

**Notes:** Cannondale (BIKE) is the only other publicly traded bike manufacturer.  
LSURE: The average of the 73 stocks in Baseline's Leisure Industry sector.

Source: Baseline

The key comparison in Table 5 is the Price/Sales ratio and Sales/Share. HUF generated almost 3 times as much Sales/Share than the sector and 2.6 times more than BIKE, yet it currently trades at a significant discount to BIKE and the sector average.

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