

# Huffy Corporation

NYSE: HUF - \$5.89

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

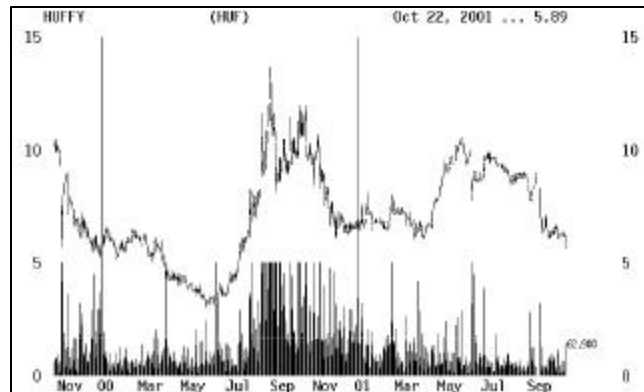
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## 3Q01 Results

## Fundamental Strengths Should Spur Stock in 2002

Current Data		EPS	P/E	
Fiscal Year End	Dec	2000	\$ 1.03	5.7
Current Price	\$ 5.89	2001E	\$ (0.08)	-77.9
52-Week Range	11-5	2002E	\$ 0.20	29.1
Shares Out (Mill)	10.5	Valuation		Current
Ave Volume LTM	47,103	P/E (Next FY)	-77.90	14-3
Market Cap. (Mill)	\$ 61.85	P/B	0.81	1.5-0.7
LTD/Total Capital	0.0%	Price/Sales	0.16	0.28-0.15
Institutional Holdings	38.0%	Operating Data		2Q01
Insider Holdings	9.3%	Sales Growth	-37.1%	-14.3%
Book Value	\$ 7.28	Operating Margin	-4.5%	2.6%
10Yr Bond	4.64%	Net Inc. Growth	157.5%	174.7%

Source: Baseline except for EPS estimates, researchstock.com



Source: Baseline

## Key Investment Points

- Sales decline as consumers reduce spending and shift to lower price points.
- Backboard and Huffy Service First continue to gain market share.
- Financial flexibility to key competitive advantages (cash hoard and no debt).
- EPS forecast reduced, our 12-18 month target price is \$7.00-\$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 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 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.

Two key factors to keep in mind are whether the September 11<sup>th</sup> attacks will spur Christmas sales and will HUF be an acquisition target.

- Christmas sales are a key near-term wild card. While the recession has caused consumers to reduced consumption and shift to lower price-points, but Christmas sales could get a boost from the emotional repercussions of September 11<sup>th</sup>.
- 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. Based upon our research, we think a takeover bid could be at a 20% premium to the current stock price.

## 3Q01 Results

This was a difficult quarter for HUF. The recession, September 11<sup>th</sup> and a difficult comparison with a very good 3Q00 (when scooter sales peaked) were bad enough, but the failed Schwinn bid added \$800,000 in expenses (about \$0.05 per share after taxes). While the Company continued to reduce SG&A expenses (ex-Schwinn), HUF posted a net loss per share of \$0.27 versus EPS of \$0.47 last year. Figures 1 and 2 illustrate sales and net income momentum, respectively.

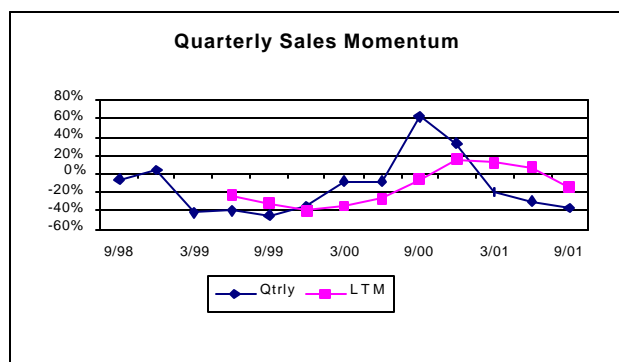


Figure 1

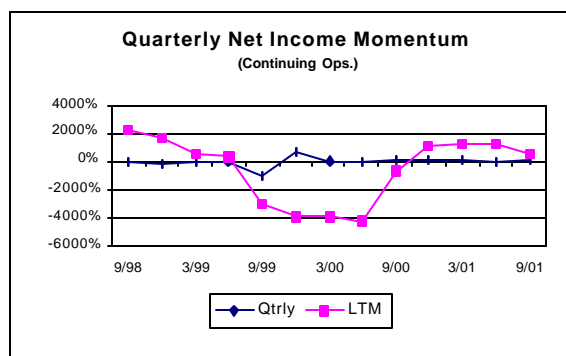


Figure 2

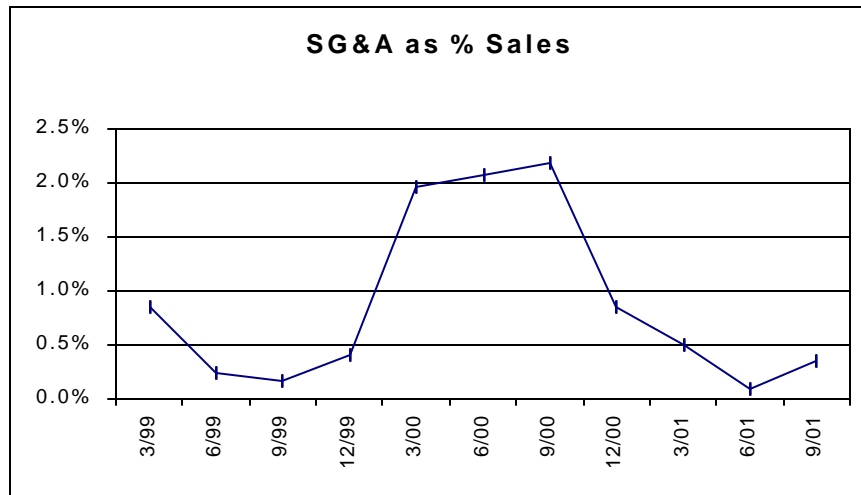
Here is a summary of operating results:

- Sales fell 37% to \$77.9 million. Excluding the \$44 million in scooter sales in 3Q00, sales declined 2.4%. Bikes sales were weak, not only because of no scooter sales, but as

consumers bought fewer bikes and shifted to lower price points. On the bright side, both basketball and Huffy Service First ("HSF") continued to show signs of strength and posted sales growth of 11% and 3%, respectively. Backboard business showed the greatest improvement as earnings increased 25% from 3Q00.

- The gross margin declined to 10% from 18% as consumers bought lower-priced bikes (that carry a smaller margin) and as HUF continued to reduce inventory overhang.
- SG&A expenses would have been relatively flat with 2Q01, had it not been for the \$800,000 in costs that were not covered by the Schwinn break-up fee. SG&A control remains one of the Company's continuing successes (see Figure 3).

Figure 3



- HUF posted its first operating loss since 4Q99 as the result of lower sales levels and tighter margins.

Tables 1 compares the operating results for the quarter and year-to-date periods.

<b>Table 1: Quarter Comparison</b>						
(\$ Million, except per share)	<b>3Q00</b>	<b>3Q01</b>	<b>Change</b>	<b>YTD 00</b>	<b>YTD 01</b>	<b>Change</b>
Revenues	123.88	77.95	-37%	345.97	246.05	-29%
Cost of Goods Sold	102.03	70.27	-31%	292.31	214.66	-27%
Gross Profit	21.84	7.68	-65%	53.67	31.39	-42%
SG&A	12.54	11.15	-11%	37.03	32.28	-13%
Plant Reconfig	-1.82	0.00	-100%	1.51	0.00	-100%
Operating Income	11.12	-3.47	-131%	15.12	-0.89	-106%
Interest Expense/ (Inc.)	2.71	0.27	-90%	7.22	0.76	-89%
Other Expenses/ (Inc.)	1.36	0.87	-36%	1.23	0.12	-91%
PreTax Income	7.04	-4.61	-165%	6.67	-1.77	-126%
Income Taxes (benefit)	2.18	-1.81	-183%	2.29	-0.73	-132%
Net Income-Cont. Ops	4.87	-2.80	-158%	4.38	-1.04	-124%
Discont. Ops.	0.37	0.00	-100%	4.23	0.00	-100%
Net Income	5.24	-2.80	-153%	8.61	-1.04	112%
EPS-Diluted	\$ 0.50	\$ (0.27)	-154%	\$ 0.84	\$ (0.10)	-112%
From Cont. ops.	\$ 0.47	\$ (0.27)	-158%	\$ 0.43	\$ (0.10)	-124%
Diluted Shares	10.386	10.323	-1%	10.27	10.40	1%
Effective Tax Rate	31%	39%		34%	41%	
<b>Margin Analysis</b>						
Gross	17.6%	9.8%	-44%	15.5%	12.8%	
EBITDAR (excl. reconstructn.)	8.7%	-2.6%	-130%	4.8%	-0.4%	
Operating	9.0%	-4.5%	-150%	4.4%	-0.4%	
Net-Continuing operations	3.9%	-3.6%	-191%	1.3%	-0.4%	

During the conference call, we noted two bright points. First, Management noted that they will continue to reduce the annual operating expense run-rate by \$10 million, which should be evident in 2002 results. Second, new product development remains strong and helped support 3Q01 results:

- The Company's new mini-bikes have experienced a good reception and placement at leading retailers.
- Lighted balls at lower price points are selling well.
- New pool backboards introduced and were well received.

HUF's financial condition remains solid with no debt and \$14 million in cash. Inventory and account receivable levels remain under control. As shown in Figure 4, Days Sales Outstanding continued to trend lower, but reduced consumer spending has adversely impacted inventory turnover. But, despite slower turnover, inventories (as measured as a percent of sales) remained under control (see Figure 5).

Figure 4

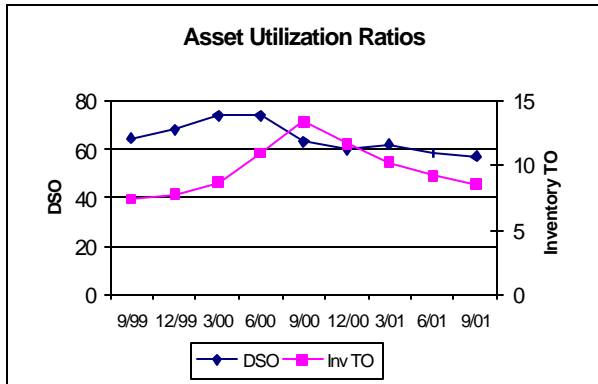
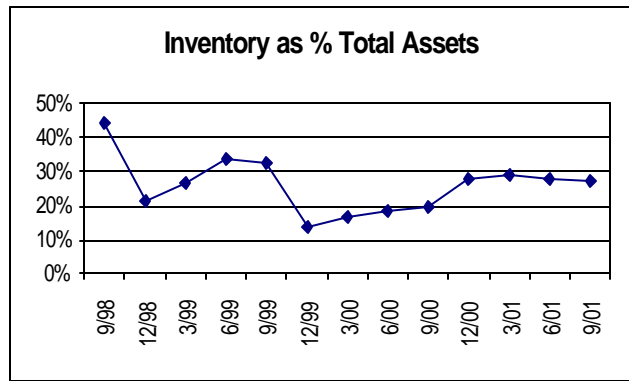


Figure 5



**Peer Group Comparisons**

While HUF is not alone in feeling the pain of the recession, it is performing relatively well for a company with a large focus on bikes. As shown in Table 2, HUF posted positive EBITDA, net income and EPS during the last 12 months, despite a significant drop in sales. Cannondale (BIKE), the only other publicly traded bicycle manufacturer underperformed during the same period.

	Sales		Margins			EPS	% Change
	\$	Growth	Gross	EBIDTA	Net		
HUF	\$560	-31%	18%	4.9%	3.0%	\$ 0.51	206.0%
BIKE	\$147	-9%	30%	6.3%	-13.5%	\$ (1.19)	-297.0%
Sector Ave.*	\$498	6%	38%	16.4%	-64.6%	\$ 0.49	-21.6%
Sales>\$500MM	\$1,493	1%	32%	12.0%	3.4%	\$ 1.13	-17.9%

\* Average of the 35 leisure time stocks in the Baseline database.  
Source: Baseline

**Outlook**

4Q01 will be very challenging as retailers have been delaying and canceling orders in the wake of September 11th. The biggest question is will retailers reorder near historic levels? In addition, we think margins will remain under pressure as the Company seeks to eliminate inventory overhang by year-end.

We reduced our EPS forecast and target price to reflect our expectation of lower sales and gross margin pressure. Our forecast for 2001 is now a loss of \$0.08 and our 2002 forecast is now \$0.20. This forecast is down slightly from our September 28<sup>th</sup> report (2001-(\$0.02), 2002-\$0.22). Our current estimate for 4Q01 is \$0.02 per share.

The key change to our 2002 outlook is that we reduced our 2002 sales growth rate from 5.0% (after 2Q01) to 2.0%. We base this assumption on our expectation of an economic recovery at mid-2002 with sales growth (if any) occurring in late 2002. However, due to the many uncertainties in today's environment, it will take time to determine if this is an aggressive or conservative assumption. Table 4 (next page) contains our annual forecast.

<b>Table 4: 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>336.1</b>	<b>342.8</b>
Cost of Goods Sold	488.6	392.2	386.1	406.8	<b>293.9</b>	<b>294.8</b>
Gross Profit	92.1	76.2	36.7	81.3	<b>42.2</b>	<b>48.0</b>
SG&A	75.7	59.7	56.2	53.8	<b>42.6</b>	<b>43.6</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>-0.4</b>	<b>4.4</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>-1.4</b>	<b>3.4</b>
Income Taxes	3.0	-2.9	-20.8	6.4	<b>-0.6</b>	<b>1.3</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>-0.8</b>	<b>2.1</b>
<b>EPS-Diluted (as reported)</b>	\$ 0.69	\$ (0.18)	\$ (3.13)	\$ 3.39	\$ <b>(0.08)</b>	\$ <b>0.20</b>
From on-going operations				\$ 1.03	\$ <b>(0.08)</b>	\$ <b>0.20</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>42%</b>	<b>38%</b>
<b>Boldface data are forecasts.</b>						
<b>Growth Rates</b>						
Sales	0.2%	0.6%	-27.6%	15.4%	<b>-31.2%</b>	<b>2.0%</b>
Net Income	22.1%	-124.2%	-1437.6%	205.1%	<b>-102.2%</b>	<b>-368.0%</b>
EPS					<b>-107.3%</b>	<b>-368.0%</b>
<b>Margin Analysis</b>						
Gross	15.9%	13.0%	8.7%	16.7%	<b>12.6%</b>	<b>14.0%</b>
Operating	2.8%	-0.8%	-13.7%	5.5%	<b>-0.1%</b>	<b>1.3%</b>
Net	1.5%	-0.4%	-7.9%	7.2%	<b>-0.2%</b>	<b>0.6%</b>

## Valuation

Our 12-18 month target price remains in the \$7.00-\$7.50 range. Our assumptions (shown in Table 5) are based upon a recovery in 2H02 and multiples that are within the stock's historical range. Other factors that may increase HUF's valuation are success of new products, recognition of the stock as a relatively stable investment relative to hi-tech alternatives, and possible acquisitions/takeover activity.

**Table 5: Target Price Calculations**

		Multiples			2002	Target
		LTM	Current*	Forecast	Estimate	Range
	Range					
<b>Price/Book</b>	High	3.3	0.8	2.0	\$ 7.17	\$ 14.35
	Low	0.9		0.9		\$ 6.46
<b>Price/Sales</b>	High	0.29	0.16	0.30	\$ 33.02	\$ 9.91
	Low	0.14		0.16		\$ 5.28
<b>P/E*</b>	High	14.0	11.5	15.0	\$ 0.20	\$ 3.04
	Low	3.0		2.0		\$ 0.41

\* Current P/E is based on 2001 EPS forecast

Average	High	\$ 9.10
	Low	\$ 4.05
	Average	\$ 6.57

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