

Harley Davidson

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### **Disclaimers**

- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

## Harley Davidson - brand and moat

- Harley Davidson motorcycles - iconic brand
  - #50 top global brand according to Business Week 2008
  - Huge brand loyalty
  - "Free riding" lifestyle
  - Brand logos tattooed on Harley lovers

## Harley Davidson - brand and moat issues

- Mostly baby boomer brand?
  - Graying customer base
- Mostly US brand (77% motorcycle sales)
  - Capturing developing markets (18% -> 30% sales)
- More intense competition with Japanese and Euro brands abroad
  - Performance cycles dominate
  - Heavy bikes banned from urban centers
- Does not resonate with younger customers?
  - Producing cycles for younger people
- Does not have active "green" energy conservation image
- Luxury priced brand - not functional enough for price/performance buyers?

## Is it a good business?

- ROE:
  - 20.7 23 24.7 24.9 26 25.7 27.6 31.1 37.8 39.3 31
- Margins
  - 16.9 16.9 15.2 13.4
  - Falling last two years due to slowdown
- Earnings falling last 2 years
- About 1 debt/equity last quarter
  - Discussed later
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - 15% 9mo 2008

## Is it a good business?

- \$1B per year in stock buyback (2005-2007)
  - At current price would buy all stock in about 4 years
  - Less buybacks (~250M) this year when it would be most beneficial..
- 250M per year in dividends (2005-2007)
- Cash flow neutral after buybacks/dividends (2005-2007)

## Is it a good business? Bad parts

- Harley Davidson Financial Services
  - Like GE financial arm
  - Provides loans for HD purchases, insurance, etc.
  - Operates as separate division
  - Floats notes for capital needs
  - Securitizes and resells mortgages... eh, loans
  - Hard to analyze, hard to discard from overall picture
  - Potentially exposes company to losses

## Is business cheap?

- ROE 15%
- Earnings in 10 years =  $ROE * Equity * (1 + ROE)^9 = \$1.3B$
- Market cap =  $\$1.3B \times P/E (15) = \$20B$
- Rate of return = ~17% after tax (calculations omitted)
- If we assume 20% ROE: 25%

## Is business cheap?

- Discounted cash flow
  - Current earnings of 770M
  - 5% growth for 10 years, leveling after that
  - 10% discount -> \$9.5B valuation
  - 20% discount -> \$5B valuation
- Owner's yield = earnings / (market cap - debt + cash)
- $770M / (2.5B + 3B - 500M) = 13\%$