

New HOLD: Harley still lacking traction

We moderate to HOLD (from Buy) with a revised target of \$2.36 p/share. We were previously encouraged by sequential improvement in SSSg in 2H18, favourable reviews of Harley's MY19 range additions and numerous internal drivers of growth. The latter still holds true, most notably MTO's efforts on used bike sales. However, new bike sales remain in decline (-7% in 1Q19) and market reaction to Harley's new models appears soft. We reduce EPS forecasts by ~25%. We wait to see improvement in Harley's market position and, to a lesser extent, stabilisation in new bike sales, before reconsidering a positive investment rating.

Key points

New bike sales remain weak. Industry sales data and MTO's AGM commentary suggest weakness continued at both headline and Harley brand levels in 1Q19. MTO new bike sales units (excl. Harley) were down 7.3%, in line with market. Harley new bike sales down 23.2%, also in line with market. We had expected the cycling of weak pcp results would help to stabilise sales growth, but that is clearly not the case.

MY19 additions have not lifted Harley. MY19 range additions are now on the market and initial traction appears soft. This has elevated our concerns over the market positioning of Harley in Australia. We understand Harley has lowered its incentive targets moderately, which is of some assistance to MTO. However, the continued sales decline represents a major headwind for group earnings.

Internal drivers remain attractive. We are encouraged by the progress made on the numerous internal drivers of growth. Most notably, MTO's increased focus on used bike sales, including ranging in MCA stores.

Earnings downgraded. We reduce EPS ~25%. Sales down ~10%, driven by weaker new bike sales, and EBITDA down ~22%, driven by sales mix (ie. Harley weakness) and operating leverage.

Balance sheet now a minor concern. FY19 Corporate ND / Adj. EBITDA at 1.5x. While this is not extreme, it does represent relatively high gearing. By way of comparison, our forecasts imply adjusted leverage ratios for APE, AHG and ASG at 1.6x, 1.6x, and 1.3x, respectively.

Valuation now looks fair. The share price implies an FY19 PER of 11.3x. This looks fair, given the elevated risks around Harley. Revised 12mth target of \$2.36 p/sh is based on an FY19 adj. EV/EBITDA of 8.0x (was 9.5x).

Risks and catalysts

Risks. Retail conditions particularly QLD, OEM relationships, regulatory reform in the provision of F&I products, changes to competitive landscape. **Catalysts.** Acquisition activity, new vehicle sales growth.

Recommendation	HOLD
12-mth target price (AUD)	\$2.36
Share price @ 07-Nov-18 (AUD)	\$2.35
Forecast 12-mth capital return	0.5%
Forecast 12-mth dividend yield	4.8%
12-mth total shareholder return	5.3%

Market cap	\$145m
Enterprise value	\$205m
Shares on issue	62m
Sold short	0.0%
ASX 300 weight	n/a
Median turnover/day	\$0.1m

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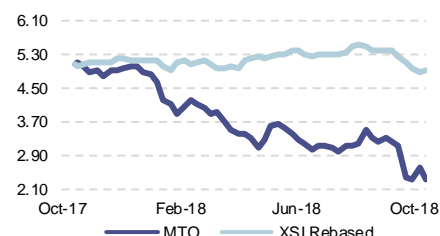
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FUNDAMENTAL
INSIGHTS

12-mth price performance (\$)



	1-mth	6-mth	12-mth
Abs return (%)	-26.6	-30.6	-52.0
Rel return (%)	-18.0	-25.4	-49.2

Key changes

		31-Aug	After	Var %
NPAT:	FY19F	17.3	12.8	-25.6%
norm	FY20F	19.6	14.3	-27.1%
	FY21F	21.6	16.1	-25.6%
EPS:	FY19F	28.0	20.8	-25.6%
norm	FY20F	31.8	23.2	-27.1%
	FY21F	35.0	26.0	-25.6%
DPS:	FY19F	15.3	11.0	-28.1%
	FY20F	17.6	12.4	-29.3%
	FY21F	19.5	14.2	-27.5%
Price target:		3.88	2.36	-39.2%
Rating:		BUY	HOLD	

Earnings forecasts

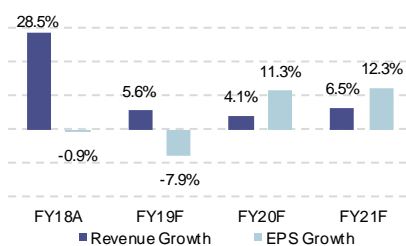
Year-end June (AUD)	FY17A	FY18A	FY19F	FY20F	FY21F
NPAT rep (\$m)	9.3	9.1	11.3	12.8	14.6
NPAT norm (\$m)	9.3	11.7	12.8	14.3	16.1
Consensus NPAT (\$m)			14.7	16.4	18.1
EPS norm (cps)	24.5	22.6	20.8	23.2	26.0
EPS growth (%)		-7.5	-7.9	11.3	12.3
P/E norm (x)	9.6	10.4	11.3	10.1	9.0
EV/EBITDA (x)	13.8	10.1	8.9	8.2	7.5
FCF yield (%)	5.3	-0.3	14.8	13.9	9.5
DPS (cps)	15.0	12.0	11.0	12.4	14.2
Dividend yield (%)	6.4	5.1	4.7	5.3	6.0
Franking (%)	100	100	100	100	100

Source: Company data, Wilsons estimates, S&P Capital IQ

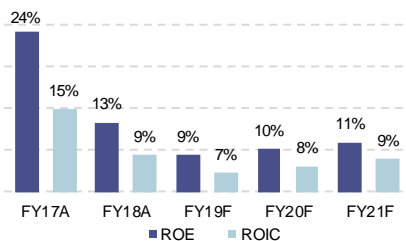
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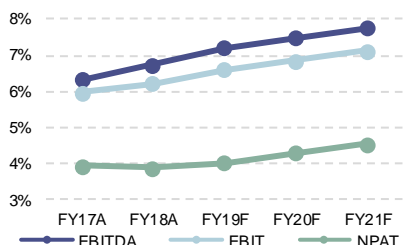
Growth rates



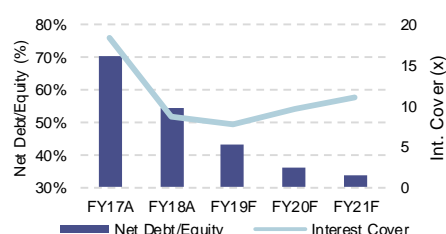
Returns



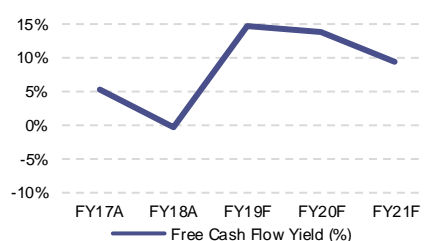
Margin trends



Solvency



Free cash flow yield



Interims (\$m)

	1H18A	2H18A	1H19E	2H19E
Sales revenue	140.1	162.3	164.0	155.3
EBITDA	9.3	11.1	12.0	11.0
EBIT	8.7	10.0	11.1	10.0
Net profit	5.7	6.1	6.8	6.0
Norm EPS	13.5	9.8	11.1	9.7
EBIT/sales (%)	6.2	6.2	6.7	6.5
Dividend (c)	7.5	4.5	5.5	5.5
Franking (%)	100.0	100.0	100.0	100.0
Payout ratio (%)	55.5	45.8	49.6	56.9
Adj payout (%)	>500	<0	30.1	44.7

Key assumptions

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Revenue growth (%)	20.8	12.4	28.5	5.6	4.1	6.5
EBIT growth (%)	64.8	12.6	33.8	12.3	8.1	10.6
NPAT growth (%)	78.0	14.6	26.3	9.6	11.3	12.3
EPS growth (%)			-7.5	-7.9	11.3	12.3
ROA (%)	15.9	15.4	8.0	9.0	9.8	10.4
ROE (%)	23.0	22.0	8.7	9.3	9.9	10.7

EBITDA (%)	6.4	6.3	6.7	7.2	7.5	7.8
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Financial ratios

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
PE (x)		9.6	10.4	11.3	10.1	9.0
EV/EBITDA (x)	15.4	13.8	10.1	8.9	8.2	7.5
Dividend yield (%)	0.0	6.4	5.1	4.7	5.3	6.0
FCF yield (%)	5.3	5.3	-0.3	14.8	13.9	9.5
Payout ratio (%)		61.3	53.0	53.0	53.7	54.4
Adj payout (%)	180.6	36.8	<0	35.7	37.1	59.6

Profit and loss (\$m)

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Sales revenue	209.3	235.3	302.4	319.3	332.3	353.8
EBITDA	13.3	14.9	20.4	23.0	24.9	27.4
Depn & amort	0.8	0.8	1.6	1.9	2.1	2.2
EBIT	12.5	14.0	18.8	21.1	22.8	25.2
Net interest expense	0.9	0.8	2.2	2.7	2.4	2.3
Tax	3.5	4.0	4.9	5.5	6.1	6.9
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	8.1	9.3	11.7	12.8	14.3	16.1
Abns/exts/signif	-2.4	0.0	-2.6	-1.5	-1.5	-1.5
Reported net profit	5.7	9.3	9.1	11.3	12.8	14.6

Cash flow (\$m)

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
EBITDA	13.3	14.9	20.4	23.0	24.9	27.4
Interest & tax	-4.3	-4.2	-9.1	-7.9	-8.2	-8.7
Working cap/other	-0.7	-2.2	-9.7	8.9	6.2	-2.0
Operating cash flow	8.3	8.5	1.6	24.0	22.9	16.7
Maintenance capex	-0.6	-0.7	-2.0	-2.5	-2.7	-2.9
Free cash flow	7.7	7.7	-0.4	21.5	20.1	13.8
Dividends paid	-13.9	-2.8	-6.2	-7.7	-7.5	-8.2
Growth capex	0.0	0.0	0.0	0.0	0.0	0.0
Invest/disposals	0.0	-4.6	-101.7	0.0	-4.6	-4.6
Oth investing/finance flows	0.6	0.0	0.0	0.0	0.0	0.0
Cash flow pre-financing	-5.6	0.3	-108.4	13.8	8.0	1.0
Funded by equity	16.0	0.0	64.8	0.0	0.0	0.0
Funded by debt	-8.1	0.0	41.6	-10.0	-10.0	0.0
Funded by cash	-2.3	-0.3	2.0	-3.8	2.0	-1.0

Balance sheet summary (\$m)

	FY16A	FY17A	FY18A	FY19F	FY20F	FY21F
Cash	4.2	4.5	2.5	6.3	4.4	5.3
Current receivables	1.5	2.9	6.8	8.0	8.3	8.8
Current inventories	37.0	45.2	87.4	83.0	79.8	84.9
Net PPE	7.0	7.5	11.2	12.0	13.0	13.9
Intangibles/capitalised	28.5	31.1	124.5	124.2	126.1	127.9
Total assets	78.3	91.4	233.7	234.9	232.8	242.2
Current payables	6.7	9.0	11.9	17.6	18.3	19.5
Total debt	30.2	34.1	76.3	66.3	56.3	56.3
Total liabilities	43.1	49.2	98.7	96.2	88.7	91.9
Shareholder equity	35.2	42.1	135.0	138.7	144.0	150.3
Total funds employed	65.4	76.2	211.4	205.0	200.4	206.7



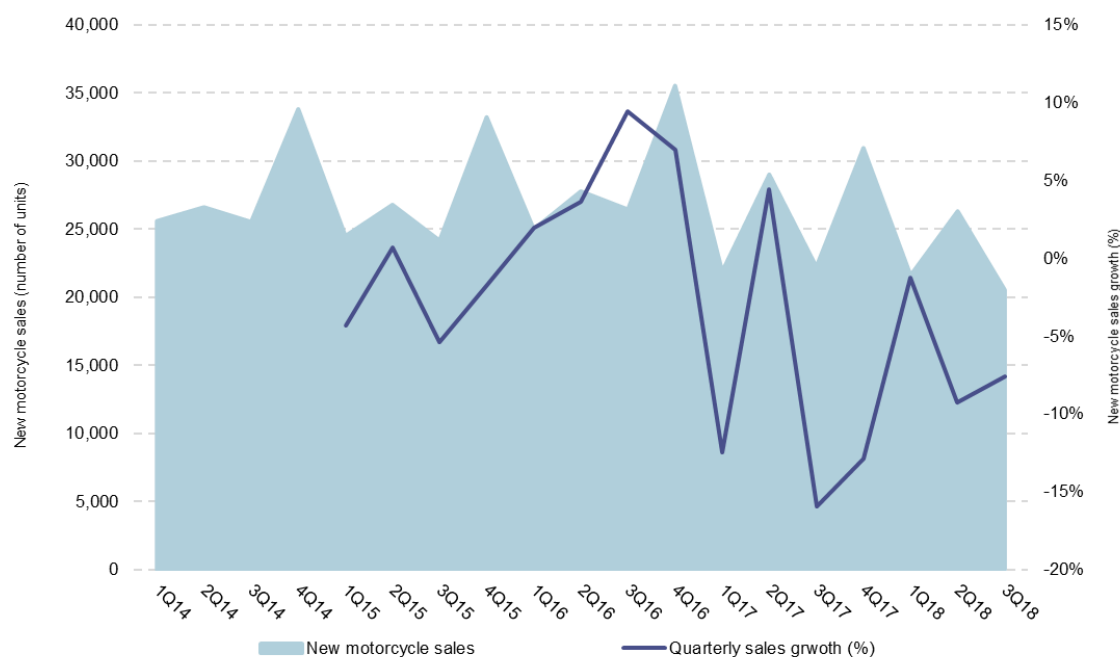
Trading update

Industry new motorcycle sales data

National new motorcycle sales for the September 2018 quarter declined 7.6%, cycling -16.0% (Jun: -9.3%, Mar: -1.2%). New bike sales excluding Harley Davidson were down 5.7%, cycling -15.9% (Jun: -8.7%, Mar: +0.9%). Harley Davidson sales were down 25.1%, cycling -16.8% (Jun: -16.3%, Mar: -19.9%).

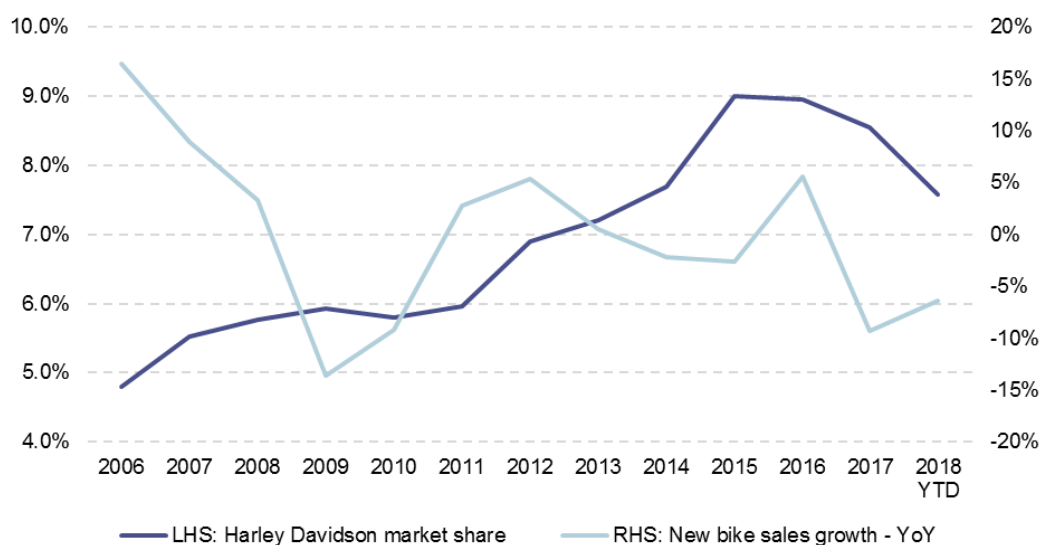
Harley Davidson's market share in Australia went through a period of acceleration between 2010 and 2015, and has since come back to a level slightly above the average since 2006.

Figure 1: New motorcycle sales in Australia



Source: FCAI & Wilsons. Note: This chart refers to financial year.

Figure 2: Harley Davidson's market share in Australia



Source: FCAI & Wilsons. Note: This chart refers to calendar year.



AGM Commentary

MTO provided a trading update at its recent AGM.

- New bike sales units (excl. Harley Davidson) were down 7.3%, in line with market. Harley Davidson new bike sales down 23.2%, also in line with market;
- Used bike performance maintained in steady market, and growing with more outlets;
- Cassons maintained profitability despite market contraction;
- Excess inventory identified in Cassons – cash flow benefit going forward;
- Minimal Capex requirement for 2019 – will strengthen cash position; and
- Warranty income recognition change, partially offset by strong Finance JV potential.

Wilson's view

New bike sales remain weak. The data series remained disappointingly weak for the September quarter. This was seen at both headline (exl. Harley) and Harley Davidson brand levels. We had expected the cycling of weak pcp results would help to stabilise sales growth, but that is clearly not the case.

MY19 additions have not lifted Harley. We previously noted the performance of Harley's MY19 additions would heavily influence the near-term growth for MTO. MY19 models are now on the market and initial traction appears below expectations. This has elevated our concerns over the market positioning of Harley in Australia. We understand Harley has lowered its incentive targets moderately, which is of some assistance to MTO. However, the continued sales decline in MTO's most profitable brand represents a major headwind for group earnings.

Internal drivers remain attractive. We are encouraged by the progress made on the numerous internal drivers of growth. Most notably, MTO's increased focus on used bike sales, including ranging in MCA stores.

Balance sheet. Our revised earnings forecasts (refer p.6 for details) imply an FY19 Corporate ND / Adj. EBITDA at 1.5x. While this is not extreme, it does represent relatively high gearing. By way of comparison, our forecasts imply adjusted leverage ratios for APE, AHG and ASG at 1.6x, 1.6x, and 1.3x, respectively.



Earnings outlook

Changes to our forecasts

A summary of the changes to our forecasts is provided in the table below.

Earnings revisions				
Year-end June (AUD)		FY19e	FY20e	FY21e
Sales - old	\$M	348.5	373.4	397.5
Sales - new	\$M	319.3	332.3	353.8
- % chg	%	(8%)	(11%)	(11%)
EBITDA (normalised) - old	\$M	29.7	32.8	35.7
EBITDA (normalised) - new	\$M	23.0	25.2	27.8
- % chg	%	(22%)	(23%)	(22%)
NPAT (normalised) - old	\$M	17.3	19.6	21.6
NPAT (normalised) - new	\$M	12.8	14.5	16.3
- % chg	%	(26%)	(26%)	(25%)
NPAT (reported) - old	\$M	15.8	18.1	20.1
NPAT (reported) - new	\$M	11.3	13.0	14.8
- % chg	%	(28%)	(28%)	(26%)
EPS (normalised) - old	\$M	28.0	31.8	35.0
EPS (normalised) - new	\$M	20.8	23.5	26.4
- % chg	%	(26%)	(26%)	(25%)
DPS - old	\$M	15.3	17.6	19.5
DPS - new	\$M	11.0	12.7	14.4
- % chg	%	(28%)	(28%)	(26%)

Source: Wilsons

EPS down 25-26%, driven by:

- Sales down 8-11%. Moderate downgrades to SSSg in FY19, driven by new bike sales, and modest downgrades in the outer years. We also remove assumptions of dealership acquisitions in FY19.
- EBITDA down 22-23%, driven by lower sales and mix (ie. sales changes primarily relate to Harley).

DPS down 26-28%, reflecting EPS changes.



Revised forecasts

A summary of our revised forecasts is provided in the table below.

Earnings summary												
Year-end June (AUD)		FY15	FY16	FY17	1H18	2H18	FY18	1H19e	2H19e	FY19e	FY20e	FY21e
Motorcycle retailing sales	\$M	173.3	209.3	235.3	135.1	147.1	282.3	150.1	142.6	292.7	305.1	325.0
Motorcycle accessories w wholesaling sales	\$M	0.0	0.0	0.0	8.1	24.9	33.0	21.8	20.2	42.0	43.1	45.6
Eliminations	\$M	0.0	0.0	0.0	(3.2)	(9.7)	(12.9)	(7.9)	(7.5)	(15.4)	(15.9)	(16.8)
Sales	\$M	173.3	209.3	235.3	140.1	162.3	302.4	164.0	155.3	319.3	332.3	353.8
- growth	%	n/a	20.8%	12.4%	16.1%	41.6%	28.5%	17.1%	(4.4%)	5.6%	4.1%	6.5%
Motorcycle retailing EBITDA	\$M	8.3	16.6	18.2	8.5	5.4	13.9	7.8	6.8	14.6	16.2	17.9
Motorcycle accessories w wholesaling EBITDA	\$M	0.0	0.0	0.0	2.4	7.5	9.9	5.9	6.1	12.0	12.7	13.7
Corporate expenses EBITDA	\$M	0.0	(3.3)	(3.3)	(1.7)	(1.8)	(3.5)	(1.7)	(1.9)	(3.6)	(3.7)	(3.8)
EBITDA	\$M	8.3	13.3	14.9	9.3	11.1	20.4	12.0	11.0	23.0	25.2	27.8
- growth	%	n/a	60.4%	12.0%	6.7%	79.4%	36.9%	29.1%	(0.7%)	12.9%	9.4%	10.3%
- margin	%	4.8%	6.4%	6.3%	6.6%	6.8%	6.7%	7.3%	7.1%	7.2%	7.6%	7.8%
Depreciation & Amortisation	\$M	0.7	0.8	0.8	0.5	1.1	1.6	0.9	1.0	1.9	2.1	2.2
- growth	%	n/a	14.0%	2.8%	37.1%	135.8%	89.6%	70.0%	(5.6%)	20.0%	7.0%	7.0%
EBIT (normalised)	\$M	7.6	12.5	14.0	8.7	10.0	18.8	11.1	10.0	21.1	23.1	25.6
- growth	%	n/a	64.8%	12.6%	5.3%	74.9%	33.8%	26.5%	(0.1%)	12.3%	9.6%	10.5%
- margin	%	4.4%	6.0%	6.0%	6.2%	6.2%	6.2%	6.7%	6.5%	6.6%	7.0%	7.2%
Bailment interest	\$M	0.5	0.4	0.4	0.1	0.6	0.7	0.3	0.4	0.7	0.8	0.9
Corporate net interest	\$M	0.5	0.4	0.4	0.7	0.8	1.5	0.9	1.1	2.0	1.6	1.4
Total net interest expense	\$M	1.0	0.9	0.8	0.8	1.4	2.2	1.3	1.5	2.7	2.4	2.3
Group PBT (normalised)	\$M	6.6	11.6	13.3	8.0	8.7	16.6	9.8	8.6	18.4	20.7	23.3
- growth	%	n/a	75.8%	14.6%	(0.1%)	62.8%	25.1%	22.9%	(1.1%)	10.4%	12.9%	12.2%
- margin	%	3.8%	5.5%	5.6%	5.7%	5.3%	5.5%	6.0%	5.5%	5.7%	6.2%	6.6%
Group NPAT (normalised)	\$M	4.6	8.1	9.3	5.7	6.1	11.7	6.8	6.0	12.8	14.5	16.3
- growth	%	n/a	78.0%	14.6%	1.8%	63.0%	26.3%	20.9%	(0.9%)	9.6%	12.9%	12.2%
- margin	%	2.6%	3.9%	3.9%	4.0%	3.7%	3.9%	4.2%	3.9%	4.0%	4.4%	4.6%
Group NPAT (reported)	\$M	3.7	5.7	9.3	4.2	4.9	9.1	6.1	5.3	11.3	13.0	14.8

Source: MTO & Wilsons.



MotorCycle Holdings (MTO)

Business description

MotorCycle Holdings Limited (MTO) is Australia's largest motorcycle dealership operator, representing 8 of the top 10 selling motorcycle brands in Australia and all top 10 selling brands in the used segment. MTO operates 41 franchises across 24 locations in Queensland, New South Wales, the Australian Capital Territory and Victoria. MTO also owns an accessories wholesaler/retailer, Cassons.

Investment thesis

We were previously encouraged by sequential improvement in SSSg in 2H18, favourable reviews of Harley's MY19 range additions and numerous internal drivers of growth. The latter still holds true, most notably MTO's efforts on used bike sales. However, new bike sales remain in decline (-7% in 1Q19) and market reaction to Harley's new models appears soft. We reduce EPS forecasts by ~25%. We wait to see improvement in Harley's market position and, to a lesser extent, stabilisation in new bike sales, before reconsidering a positive investment rating.

Revenue drivers

- New motorcycle sales growth
- Industry consolidation
- Growth potential in accessories sales

Margin drivers

- Sales mix
- OEM incentive payments
- Efficiency of scale

Key issues/catalysts

- Acquisition profile
- New motorcycle sales growth

Risk to view

- Retail condition
- Regulatory reform in the provision of F&I products
- Market concentration in QLD

Balance sheet

- FY18 corporate net debt: \$49.5M

Board

- David Foster – Chairman
- David Ahmet – MD & CEO
- Rob Cassen – Executive Director
- Warren Bee – Independent Non-Executive Director
- Rick Dennis – Independent Non-Executive Director

Management

- David Ahmet – MD & CEO
- Eddie MacDonald - CFO
- Chris Chenoweth – General Manager and Group Bike Sales
- Mike Cooksley – Group Finance and Insurance
- Russell Lemon – Group Service
- Shane Musgrove – Group Parts and Accessories

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