Date
13 December 2017

Theme
Company Update

WILSONS

Company
MotorCycle Holdings (MTO)

BUY: Keep riding

We retain a BUY rating with a revised 12-month target of $5.39 p/sh. MotorCycle Holdings recently delivered a mixed AGM update, with soft new bike sales partly offset by robust used bike sales and additional acquisitions/greenfields. We lower EPS 4-8%. In this report we also take the opportunity to assess dealership margins and Cassons earnings sensitivity. MTO retains an outlook for sustained growth driven by further dealership acquisitions and aided by significant synergy opportunities with Cassons.

Key points

AGM trading update. YTD new bike sales down 5.4% (market: -15.4%), reflecting the cycling of a strong pcp, while used bike sales are up 14.1%. Reduced insurance commissions commenced in October.

Acquisitions & greenfields. MTO is acquiring three dealerships (Frankston Yamaha & Honda and Central Coast Harley-Davidson) and has been appointed to develop a Yamaha greenfield site on the Sunshine Coast.

New finance JV. MTO is negotiating to establish a 50:50 JV with Allied credit, a motorcycle industry finance company, to provide motorcycle loans to MTO's customers. The JV will commence early CY18 and is expected to deliver material earnings stream over the next three years.

Wilsons' view. Trading conditions are directionally consistent with our forecasts, but the quantum of decline in new bike sales is larger than expected. Robust used bike sales growth demonstrates the underlying health of the dealership network. The pace of acquisitions is above our previous expectations (we now forecast five in FY18 vs two previously). We estimate the new insurance JV could generate ~$2.0M of earnings within three years.

Forecasts. EPS down 4-8%. Sales down 0-2%, reflecting the weaker than expected trading conditions in FY18 (ie. lower new bike sales), partly offset by contributions from additional acquisitions/greenfields. EBITDA (normalised) down 3-6%, reflecting changes in sales and some fixed cost leverage (refer p.6 for margin analysis). We forecast ~$2.7M EBITDA contribution from Cassons in 1H18 and $11.1M for the full year, with transactions costs treated as significant items. Refer p.7 for Cassons earnings sensitivity analysis.

Valuation. Our revised 12-month target of $5.39 p/sh is based on an FY19 adj. EV/EBITDA of 10.5x (implied PER of 15.2x). The increase reflects a full roll forward in our valuation year to FY19.

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	BUY
12-mth target price (AUD)	**$5.39**
Share price @ 12-Dec-17 (AUD)	$4.81
Forecast 12-mth capital return	12.0%
Forecast 12-mth dividend yield	3.8%
12-mth total shareholder return	**15.8%**
Market cap	$297m
Enterprise value	$365m
Shares on issue	62m
Sold short	0.4%
ASX 300 weight	n/a
Median turnover/day	$0.2m

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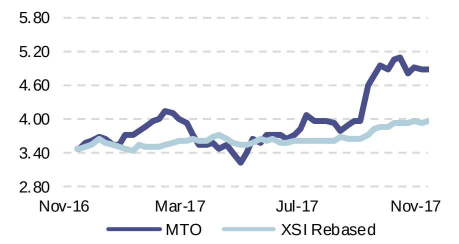
12-mth price performance ($)



	1-mth	6-mth	12-mth
Abs return (%)	-6.3	37.5	46.2
Rel return (%)	-7.6	24.9	31.4

Earnings forecasts

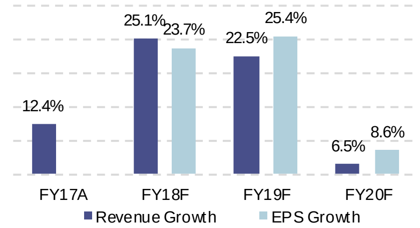
Year-end June (AUD)	FY16A	FY17A	FY18F	FY19F	FY20F
NPAT rep ($m)	5.7	9.3	12.1	20.4	22.2
NPAT norm ($m)	8.1	9.3	14.6	21.9	23.7
Consensus NPAT ($m)					
EPS norm (cps)		22.8	28.2	35.4	38.5
EPS growth (%)			23.7	25.4	8.6
P/E norm (x)		21.1	17.0	13.6	12.5
EV/EBITDA (x)	27.4	24.5	15.2	10.3	9.6
FCF yield (%)	2.6	2.6	4.5	8.0	7.6
DPS (cps)	0.0	15.0	16.9	21.2	23.1
Dividend yield (%)	0.0	3.1	3.5	4.4	4.8
Franking (%)	0	100	100	100	100

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

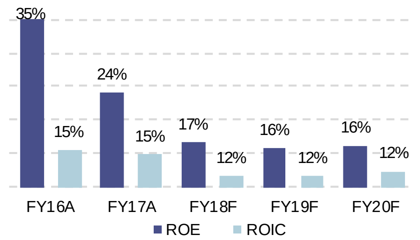
Key changes

		09-Oct	After	Var %
NPAT:	**FY18F**	15.8	14.6	-7.5%
norm	**FY19F**	22.8	21.9	-4.3%
($m)	**FY20F**	25.4	23.7	-6.5%
EPS:	**FY18F**	30.5	28.2	-7.5%
norm	**FY19F**	37.0	35.4	-4.3%
(cps)	**FY20F**	41.1	38.5	-6.5%
DPS:	**FY18F**	18.3	16.9	-7.4%
(cps)	**FY19F**	22.2	21.2	-4.3%
	FY20F	24.7	23.1	-6.5%
Price target:		5.15	5.39	4.6%
Rating:		**BUY**	**BUY**	

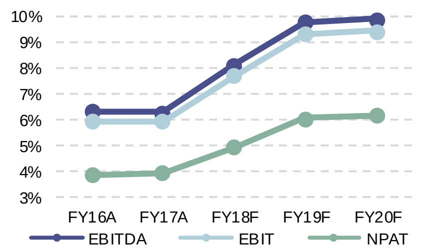
Growth rates



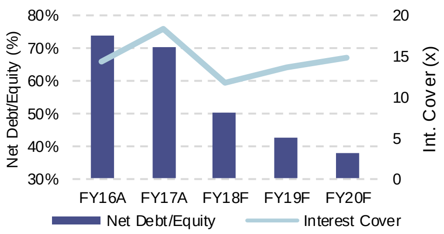
Returns



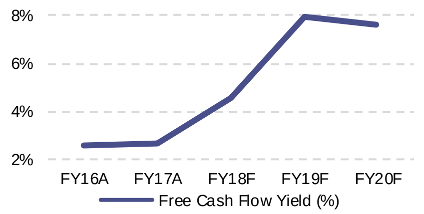
Margin trends



Solvency



Free cash flow yield



Interims ($m)

	1H17A	2H17A	1H18E	2H18E
Sales revenue	120.7	114.6	134.0	160.3
EBITDA	8.7	6.2	9.7	14.4
EBIT	8.3	5.7	9.2	13.6
Net profit	**5.6**	**3.7**	**5.9**	**8.7**
Norm EPS	**13.7**	**9.1**	**14.1**	**14.2**
EBIT/sales (%)	6.9	5.0	6.9	8.5
Dividend (c)	0.0	15.0	7.5	9.4
Franking (%)	0.0	100.0	100.0	100.0
Payout ratio (%)	0.0	164.2	53.3	66.6
Adj payout (%)	0.0	54.4	73.0	54.5

Key assumptions

	FY16A	FY17A	FY18F	FY19F	FY20F
Revenue growth (%)	20.8	12.4	25.1	22.5	6.5
EBIT growth (%)	64.8	12.6	62.4	47.7	7.9
NPAT growth (%)	78.0	14.6	57.7	49.4	8.6
EPS growth (%)			**15.5**	**25.4**	**8.6**
ROA (%)	15.9	15.4	10.0	14.1	14.4
ROE (%)	23.0	22.0	10.9	15.3	15.7
EBITDA (%)	6.4	6.3	8.2	9.8	9.9

Financial ratios

	FY16A	FY17A	FY18F	FY19F	FY20F
PE (x)		21.4	17.3	13.8	12.7
EV/EBITDA (x)	27.4	24.5	15.2	10.3	9.6
Dividend yield (%)	0.0	3.1	3.5	4.3	4.7
FCF yield (%)	2.6	2.6	4.5	8.0	7.6
Payout ratio (%)	�	65.7	60.0	60.0	60.0
Adj payout (%)	180.6	36.8	59.9	51.6	60.9

Profit and loss ($m)

	FY16A	FY17A	FY18F	FY19F	FY20F
Sales revenue	209.3	235.3	294.2	360.3	383.8
EBITDA	13.3	14.9	24.0	35.4	38.2
Depn & amort	0.8	0.8	1.2	1.7	1.8
EBIT	**12.5**	**14.0**	**22.8**	**33.7**	**36.4**
Net interest expense	0.9	0.8	1.9	2.5	2.5
Tax	3.5	4.0	6.3	9.4	10.2
Minorities/pref divs	0.0	0.0	0.0	0.0	0.0
Equity accounted NPAT	0.0	0.0	0.0	0.0	0.0
Net profit (pre-sig items)	**8.1**	**9.3**	**14.6**	**21.9**	**23.7**
Abns/exts/signif	-2.4	0.0	-2.5	-1.5	-1.5
Reported net profit	**5.7**	**9.3**	**12.1**	**20.4**	**22.2**

Cash flow ($m)

	FY16A	FY17A	FY18F	FY19F	FY20F
EBITDA	13.3	14.9	24.0	35.4	38.2
Interest & tax	-4.3	-4.2	-6.1	-9.1	-12.3
Working cap/other	-0.7	-2.2	-3.0	-0.9	-1.3
Operating cash flow	**8.3**	**8.5**	**14.9**	**25.4**	**24.6**
Maintenance capex	-0.6	-0.7	-1.5	-1.8	-2.0
Free cash flow	**7.7**	**7.7**	**13.4**	**23.6**	**22.6**
Dividends paid	-13.9	-2.8	-8.1	-12.2	-13.8
Growth capex	0.0	0.0	0.0	0.0	0.0
Invest/disposals	0.0	-4.6	-131.8	-4.8	-4.8
Oth investing/finance flows	0.6	0.0	0.0	0.0	0.0
Cash flow pre-financing	**-5.6**	**0.3**	**-126.4**	**6.6**	**4.0**
Funded by equity	16.0	0.0	88.2	0.0	0.0
Funded by debt	-8.1	0.0	34.3	-5.0	0.0
Funded by cash	-2.3	-0.3	3.9	-1.6	-4.0

Balance sheet summary ($m)

	FY16A	FY17A	FY18F	FY19F	FY20F
Cash	4.2	4.5	0.6	2.3	6.3
Current receivables	1.5	2.9	8.8	9.0	9.6
Current inventories	37.0	45.2	85.3	91.9	97.9
Net PPE	7.0	7.5	8.1	8.6	9.2
Intangibles/capitalised	28.5	31.1	124.9	127.1	129.0
Total assets	**78.3**	**91.4**	**227.9**	**239.0**	**252.1**
Current payables	6.7	9.0	15.5	17.2	18.3
Total debt	30.2	34.1	68.4	63.4	63.4
Total liabilities	**43.1**	**49.2**	**93.5**	**96.4**	**101.1**
Shareholder equity	**35.2**	**42.1**	**134.4**	**142.6**	**151.0**
Total funds employed	**65.4**	**76.2**	**202.8**	**206.0**	**214.4**

AGM update

Trading update

YTD new bikes sales down 5.4% (market: -15.4%) and used bike sales up 14.1%, reflecting weak market conditions and the cycling of a strong pcp. Reduced insurance commissions commenced in October. The 1H18 result will reflect the weak market conditions in motorcycle sales, with profits from Cassons offset by associated acquisition costs.

Acquisitions & greenfields

MTO is acquiring three dealerships, being Frankston Yamaha & Honda and Central Coast Harley-Davidson which is subject to OEM approval. MTO has been appointed to develop a Yamaha greenfield site on the Sunshine Coast.

New finance JV

MTO is negotiating to establish a 50:50 JV with Allied credit, a leading motorcycle industry finance company, to provide secured loans to MTO customers requiring funding to acquire a motorcycle. The JV will commence early CY18 and is expected to deliver material earnings stream over the next three years.

Wilsons' view

Trading update. Trading conditions are directionally consistent with our forecasts, given the cycling of a strong pcp (best six months in the past five years). But the quantum of decline in new bike sales is larger than our expectations. Used bike sales growth is broadly consistent with our expectation.

Acquisitions & greenfields. The quantum of dealership acquisitions is exceeding our forecasts, demonstrating an encouraging pipeline of future activity.

New finance JV. MTO's new finance JV partner Allied Credit was established in 2010 and has a number of existing alliance businesses with brands such as Kawasaki, Peter Stevens and Mercury Marine. We estimate this JV could generate ~$2.0M of earnings within three years.

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)		**FY18e**	**FY19e**	**FY20e**
Sales - old	$M	301.2	360.5	383.9
Sales - new	**$M**	**294.2**	**360.3**	**383.8**
- % chg	*%*	*(2%)*	*(0%)*	*(0%)*
EBITDA (normalised) - old	$M	25.7	36.5	39.9
EBITDA (normalised) - new	**$M**	**24.0**	**35.4**	**38.2**
- % chg	*%*	*(6%)*	*(3%)*	*(4%)*
NPAT (normalised) - old	$M	15.8	22.8	25.4
NPAT (normalised) - new	**$M**	**14.6**	**21.9**	**23.7**
- % chg	*%*	*(8%)*	*(4%)*	*(6%)*
NPAT (reported) - old	$M	14.8	21.3	23.9
NPAT (reported) - new	**$M**	**12.1**	**20.4**	**22.2**
- % chg	*%*	*(18%)*	*(5%)*	*(7%)*
EPS (normalised) - old	$M	30.5	37.0	41.1
EPS (normalised) - new	**$M**	**28.2**	**35.4**	**38.5**
- % chg	*%*	*(8%)*	*(4%)*	*(6%)*
DPS - old	$M	18.3	22.2	24.7
DPS - new	**$M**	**16.9**	**21.2**	**23.1**
- % chg	*%*	*(7%)*	*(4%)*	*(6%)*

Source: Wilsons

EPS down 4-8%:

- Sales down 0-2%, reflecting the weaker-than-expected trading conditions in FY18 (ie. lower new bike sales), partly offset by contributions from additional acquisitions/greenfields.
- EBITDA (normalised) down 3-6%, reflecting changes in sales and some fixed cost leverage. We forecast ~$2.7M EBITDA contribution from Cassons in 1H18 and $11.1M for the full year, with transactions costs treated as significant items.
- DPS down 4-7% to reflect the decline in EPS.

Revised forecasts

A summary of our revised forecasts is provided in the tables below and overleaf.

Segment earnings summary											
Year-end June (AUD)		**FY15**	**FY16**	**1H17**	**2H17**	**FY17**	**1H18e**	**2H18e**	**FY18e**	**FY19e**	**FY20e**
Dealerships	#	34	34	34	41	41	43	47	47	50	53
- growth	%	6.3%	0.0%	0.0%	20.6%	20.6%	26.5%	14.6%	14.6%	6.4%	6.0%
New motorcycles	$M	69.0	89.6	54.9	52.5	107.4	52.4	57.7	110.1	121.1	128.9
Used motorcycles	$M	53.2	59.2	32.2	31.3	63.4	36.7	35.0	71.7	79.6	85.9
Parts & Accessories	$M	27.5	32.2	17.9	16.9	34.8	18.4	19.0	37.4	40.4	43.3
Service	$M	8.1	9.6	5.3	4.9	10.2	6.1	5.5	11.6	12.9	13.8
Other	$M	5.2	6.6	3.0	1.8	4.8	2.7	3.1	5.8	6.2	6.6
Commission	$M	10.3	12.0	8.3	7.9	16.1	6.2	6.4	12.7	14.2	15.5
Cassons	$M	0.0	0.0	0.0	0.0	0.0	13.0	37.3	50.3	95.2	99.4
Eliminations	$M	0.0	0.0	(0.8)	(0.7)	(1.5)	(1.5)	(3.8)	(5.3)	(9.2)	(9.6)
Sales revenue	**$M**	**173.3**	**209.3**	**120.7**	**114.6**	**235.3**	**134.0**	**160.3**	**294.2**	**360.3**	**383.8**
New motorcycles growth	%	n/a	29.9%	21.9%	17.7%	19.8%	(4.5%)	9.8%	2.5%	10.0%	6.5%
Used motorcycles growth	%	n/a	11.4%	7.9%	6.3%	7.1%	14.0%	12.0%	13.0%	11.0%	8.0%
Parts & Accessories growth	%	n/a	17.1%	8.5%	7.9%	8.2%	3.0%	12.3%	7.5%	8.0%	7.0%
Service growth	%	n/a	18.7%	9.7%	3.6%	6.6%	15.0%	11.9%	13.5%	11.0%	7.0%
Other growth	%	n/a	27.7%	3.8%	(51.9%)	(27.7%)	(10.5%)	70.6%	20.0%	7.0%	7.0%
Commission growth	%	n/a	16.3%	36.5%	31.8%	34.2%	(24.4%)	(18.1%)	(21.3%)	12.0%	9.0%
Cassons growth	%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	89.4%	4.4%
Eliminations growth	%	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	75.0%	4.0%
Sales revenue growth	%	5.9%	20.8%	14.9%	10.0%	12.4%	11.0%	39.8%	25.1%	22.5%	6.5%
Dealerships organic sales growth	%	n/a	7.1%	15.6%	2.3%	9.0%	(9.6%)	2.6%	(3.9%)	3.5%	3.3%
Dealerships	$M	44.9	54.5	32.3	30.0	62.3	32.1	32.7	64.8	71.6	77.0
Cassons	$M	0.0	0.0	0.0	0.0	0.0	5.8	17.0	22.7	43.1	45.0
Gross profit	**$M**	**44.9**	**54.5**	**32.3**	**30.0**	**62.3**	**37.8**	**49.7**	**87.5**	**114.7**	**122.0**
- growth	%	n/a	21.4%	15.4%	13.1%	14.3%	17.3%	65.4%	40.5%	31.1%	6.4%
- margin	%	25.9%	26.0%	26.7%	26.2%	26.5%	28.2%	31.0%	29.7%	31.8%	31.8%
Opex	$M	(36.6)	(41.2)	(23.6)	(23.8)	(47.4)	(28.2)	(35.3)	(63.5)	(79.4)	(83.9)
- growth	%	n/a	12.5%	13.5%	16.7%	15.1%	19.5%	48.1%	33.9%	25.0%	5.7%
- margin	%	21.1%	19.7%	19.5%	20.8%	20.1%	21.0%	22.0%	21.6%	22.0%	21.9%
Dealerships	$M	8.3	13.3	8.7	6.2	14.9	7.0	6.0	13.0	14.8	16.8
Cassons	$M	0.0	0.0	0.0	0.0	0.0	2.7	8.4	11.1	20.5	21.4
EBITDA	**$M**	**8.3**	**13.3**	**8.7**	**6.2**	**14.9**	**9.7**	**14.4**	**24.0**	**35.4**	**38.2**
- growth	%	n/a	60.4%	21.1%	1.3%	12.0%	11.2%	132.0%	61.4%	47.0%	7.9%
- margin	%	4.8%	6.4%	7.2%	5.4%	6.3%	7.2%	9.0%	8.2%	9.8%	9.9%

Source: MTO & Wilsons.

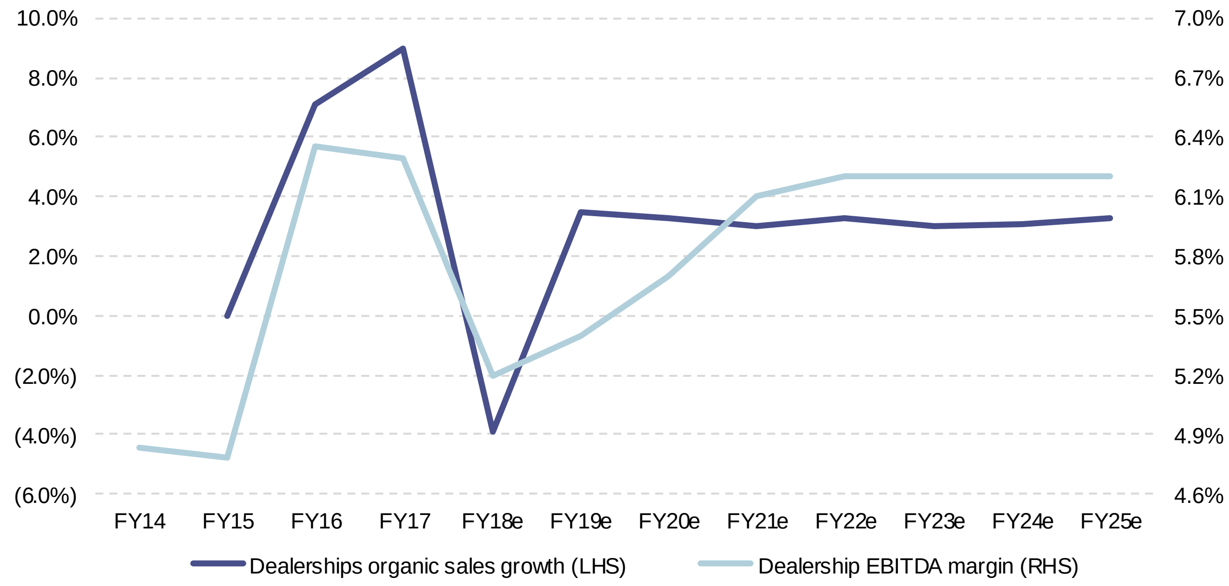
With the adjustments to our sales forecasts, following MTO's AGM trading update, we take the opportunity to analyse the related impact on margins.

Figure 1 shows our estimate of organic dealership sales growth vs the dealership EBITDA margin. This illustrates the fixed cost leverage to changes in the quantum of sales growth. We also note the stronger sales growth in FY17 did not translate into stronger margin, with MTO estimating ~40bps of margin drag from dealerships acquired in the period. For this same reason, we forecast a more gradual improvement in margins over the forecast period.

Figure 2 shows our estimate of average sales per dealership vs the dealership EBITDA margin. The stronger sales figures in FY16 and FY17 align with a period of stronger margins.

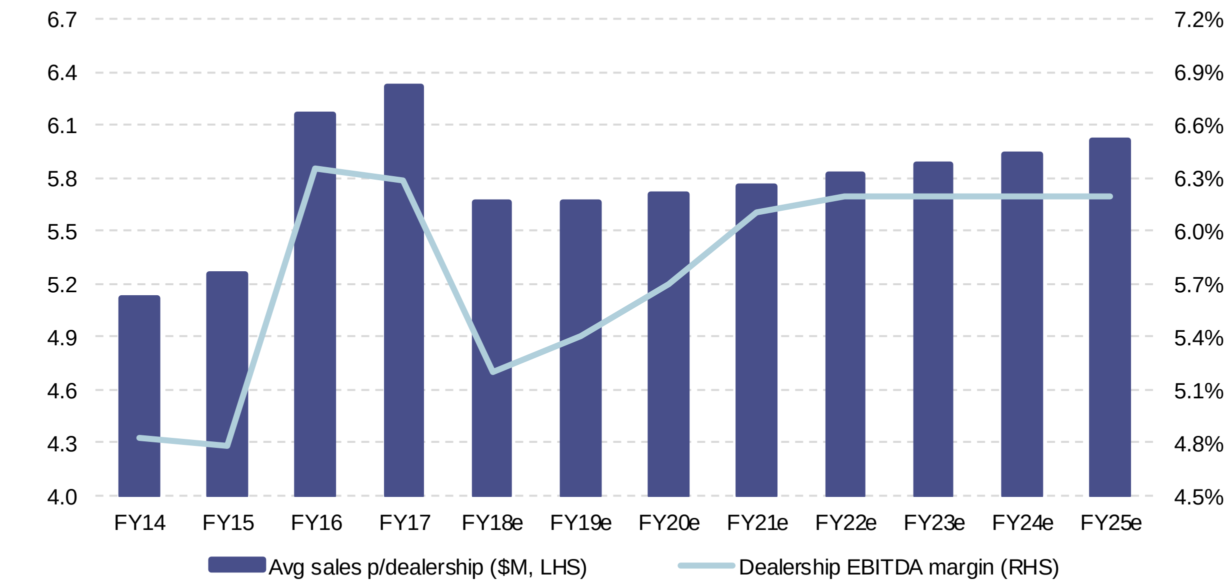
With the benefit of additional scale as the network of dealerships increase, we expect long term margins to reach a level slightly below the margins achieved in FY16 and FY17.

Figure 1: Dealership organic sales growth vs EBITDA margin



Source: MTO & Wilsons.

Figure 2: Average sales p/dealership vs EBITDA margin



Source: MTO & Wilsons.

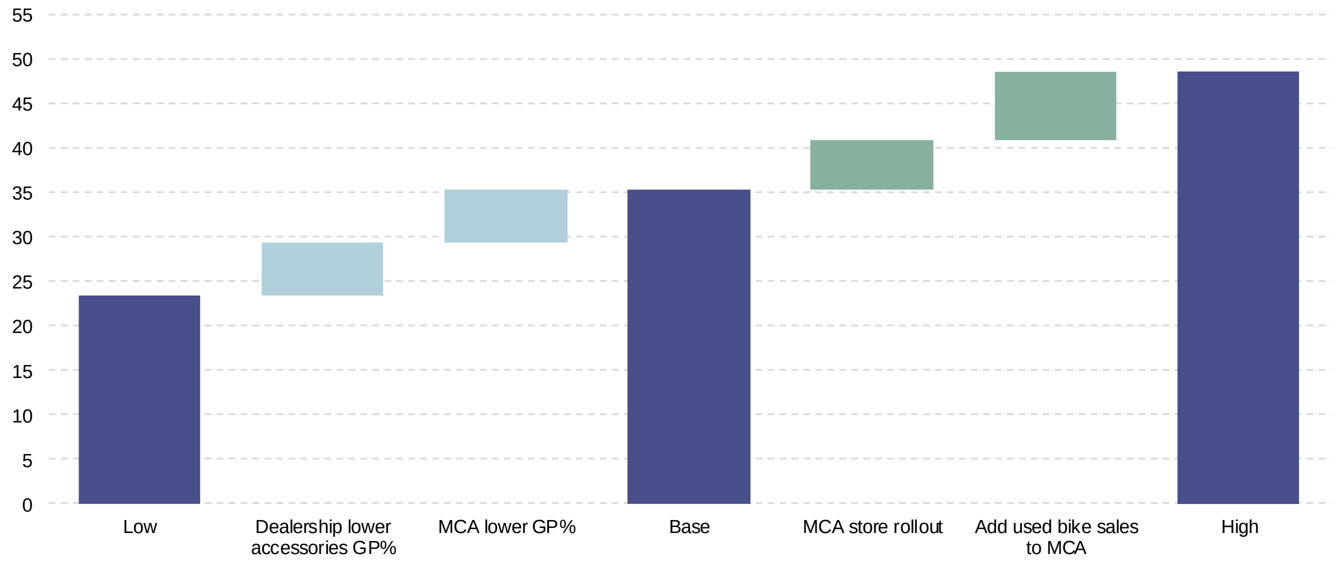
Cassons earnings sensitivity

We take the opportunity to assess several factors that could affect Cassons' earnings profile. We use our FY19 group EBITDA forecast as the reference point.

Upside. Cassons currently operates 8 MCA stores (including Keilor Park, due to open at the end of CY17). We assess opportunity to increase this network to 15-20 stores. We assess another 10 stores would add $5.5M of EBITDA. The MCA stores do not currently sell used bikes. Assuming sales of 30 bikes per store per month at $1,200 EBITDA per bike across the expanded 18 store network, this would add $7.8M of EBITDA.

Downside. With Cassons being a major customer across its supplier network, we expect pricing would be comparable with any other major wholesaler. We therefore see minimal risk of margin disruption at the wholesale level. However, with both the MCA stores and dealerships generating ~45% gross retail margins on accessories, we identify retail margin pressure here as a potential risk. We assess a decline in accessories gross margin from 45% to 30% across the MCA store network and dealership network would reduce EBITDA by $6.0 each (or a combined total of $12.0M).

Figure 3: MTO FY19 EBITDA sensitivity to Cassons-related factors



Source: MTO & Wilsons.

Valuation

Our 12-month target price of $5.39 p/sh is based on an FY19 adjusted EV/EBITDA of 10.5x (implied PER of 15.2x).

Earnings capitalisation					
Year-end June (AUD)		**FY17**	**FY18e**	**FY19e**	**FY20e**
Wilsons valuation					
EBITDA (normalised)	$M	14.9	24.0	35.4	38.2
- less bailment interest	$M	(0.4)	(0.5)	(0.6)	(0.7)
- less other adjustment	$M	(0.0)	(0.0)	(0.0)	(0.0)
Adjusted EBITDA (normalised)	**$M**	**14.5**	**23.6**	**34.8**	**37.4**
Multiple	x	10.5x	10.5x	10.5x	10.5x
Enterprise value	$M	153.2	248.4	366.3	394.7
- less Corporate net debt	$M	(6.5)	(42.8)	(33.7)	(27.7)
- less other adjustment	$M	(0.0)	(0.0)	(0.0)	(0.0)
Equity value	**$M**	**146.7**	**205.6**	**332.6**	**367.1**
Equity value p/share	**$**	**3.87**	**3.97**	**5.39**	**5.95**
- implied PER	x	15.8x	14.1x	15.2x	15.5x
Valuation at current share price					
Enterprise value	$M	179.5	279.1	315.1	309.1
EV / EBITDA	x	12.4x	11.8x	9.1x	8.3x
EV / EBIT	x	13.1x	12.5x	9.5x	8.7x
PER	x	18.6x	16.1x	12.9x	11.9x

Source: Wilsons.

This is supported by a DCF valuation of $5.38 p/share.

DCF valuation					
Cost of capital			**Cash flows**		
Risk free rate	%	5.0	PV of FCF forecast (10 yrs)	$M	158.7
Market risk premium	%	6.0	PV of terminal value	$M	163.0
Beta (levered)	x	1.1	**Enterprise value**	**$M**	**321.7**
Cost of equity	%	11.9			
Cost of debt (pre tax)	%	7.0	Net debt / (cash)	$M	42.8
Target Gearing (D/D+E)	%	20.0	Deferred consideration	$M	0.0
Corporate tax rate	%	29.0	**Equity value**	**$M**	**278.8**
WACC (pre tax)	%	10.9	Shares on issue	M	51.8
WACC (post tax)	**%**	**10.5**	**DCF valuation**	**$**	**5.38**

Source: 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

MTO recently delivered a mixed AGM update, with soft new bike sales partly offset by robust used bike sales and additional acquisitions/greenfields. We lower EPS 4-8%. In this report we also take the opportunity to assess dealership margins and Cassons earnings sensitivity. MTO retains an outlook for sustained growth driven by further dealership acquisitions and aided by significant synergy opportunities with Cassons.

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

- FY17 corporate net debt: $6.5M

Board

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

Management

- David Ahmet – MD & CEO
- Chris Chenoweth – General Manager and Group Bike Sales
- Bob Donovan – Chief Financial Officer
- Mike Cooksley – Group Finance and Insurance
- Russell Lemon – Group Service
- Shane Musgrove – Group Parts and Accessories

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Disclaimers and disclosures

Recommendation structure and other definitions

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