Harley-Davidson, Inc., owns one of America’s most successful consumer brands, if its intensely loyal customers are any measure. Baby boomers predominate among its fans — the average owner is 46. Therein lies a potential trap, however. Aging riders eventually will have to clamber down from their bikes and trade the open road for a quieter lifestyle. Some skeptics question whether the Milwaukee-based company can attract comparable numbers of young consumers to replace the oldsters and sustain long-term growth.

Harley-Davidson doesn’t plan to throttle back any time soon, though. Management says the demographics for its business are quite positive, and the company has expanded its production capacity. Harley-Davidson also is working to broaden its customer base.

Even so, its price-earnings multiples have pulled back from the lofty levels seen around the turn of the century. In addition, its share price is down from a high of almost $64 in mid-July.

One reason may be that comparisons of its recent financials are difficult; the company experienced a sales boost in 2002 and 2003 from promotions related to its 100th-anniversary celebration. In addition, the company extended its 2003 production year to 14 months in connection with the anniversary. Management contends sales growth isn’t decelerating but simply returning to the company’s historical norms.

Members of Better Investing’s Editorial Advisory and Securities Review Committee concluded recent valuations may not accurately reflect the company’s quality and growth potential. They therefore selected Harley-Davidson, Inc., as the January Undervalued Feature.

Marketing Strategies
Harley-Davidson is taking steps to appeal to a more diverse audience. In 2001 the company introduced the V-Rod, a light performance machine powered by the company’s first liquid-cooled engine. The model targets young consumers who often prefer performance motorcycles of the kind marketed by Harley-Davidson’s competitors — particularly Japanese makers such as Honda, Suzuki, Kawasaki and Yamaha. The company’s Buell line of entry-level machines is also aimed at young buyers.

The company is seeing strong sales of its lighter Sportster models, which have been reduced in price and redesigned with lower seats, smaller handgrips and easier-to-pull clutch levers. The changes are intended to appeal to women, who now buy 10 percent of all Harley-Davidson machines. Management also hopes the greater emphasis on inexpensive, sportier bikes will entice foreign customers away from competing brands.

Management continues to regulate production, avoiding the trap of making more motorcycles than demand justifies. As a result, customers have faced wait times of up to a year for delivery of some models. Management does intend to narrow the gap between supply and demand, however. In 2003 the company expanded facilities in York, Pa., to produce more of its Softail models.

Sales historically have grown 7 percent to 9 percent, management reports, and it’s basing annual production goals on that range. The company produced more than 291,000 units in fiscal 2003, and it expected to make 317,000 motorcycles in fiscal 2004. Harley-Davidson anticipates reaching the 400,000 level in 2007.

Certain factors could slow Harley-Davidson’s cruise in coming quarters, however. A recession could sap the inclination of consumers to buy big-ticket items such as motorcycles. The company could encounter difficulties drawing younger consumers into the Harley-Davidson fold. Higher interest rates could hurt its lending arm
and make bikes less affordable to payment-conscious customers.

Company Background
Motorcycles accounted for $3.7 billion of fiscal-2003 net revenues, 80 percent of the total. The company's namesake machines include well-known lines such as Electra Glide, Dyna Glide, Softail and Sportster. The company's lighter, lower-priced Buell models generated 1.7 percent of sales.

Parts and Accessories generated $713 million in sales, 15.4 percent of net revenues. An additional $211 million — 4.6 percent — came from General Merchandise, which markets themed items such as clothing and jewelry. The company received $38 million in licensing royalties.

Jeffrey L. Bleustein, 64, serves as chairman and CEO. He and other company insiders together owned 1.5 percent of the 295.1 million common shares outstanding, according to the March 2004 proxy statement. In September 2004 institutional owners held 73.2 percent of the shares, reports the Factiva financial data service.

Financial Results
Harley-Davidson earned $760.9 million in fiscal 2003 (ended Dec. 31, 2003) excluding special items, up 31.1 percent from $580.2 million the previous year. Diluted earnings per share totaled $2.50 excluding special items, versus $1.90 the year before. Revenues totaled $4.6 billion, up 13 percent from $4.1 billion in fiscal 2002. Foreign business accounted for about 18 percent of fiscal 2003 revenues.

For the year to date through Sept. 30, net income before special items stood at $680.8 million, up 17.7 percent from $578.5 million in the year-earlier period. Diluted EPS totaled $2.28, compared with $1.90 a year earlier. Revenues amounted to $3.8 billion, up 9.2 percent from $3.5 billion in the year-earlier period.

The company is paying a quarterly dividend of $.10 — $.40 a year. It boosted the quarterly payout to $.08 from $.04 in fourth-quarter 2003 and raised the dividend to its current level in second-quarter 2004. The company issued 2-for-1 stock splits in 1992, 1994, 1997 and 2000. It offers investors the options of dividend reinvestment and direct purchase of its common stock shares.

The goal for the Undervalued Stock is a 20-percent increase in investment value (market appreciation plus any dividends) in 18 to 24 months. No investment recommendation is intended.

Performance Expectations
The stock's price at the time of selection was $59.03. Near press time in mid-November, shares were being traded at $59.64. At the recent share price the company's market capitalization stood at $17.3 billion. The stock's recent 52-week trading range was $44.57 to $63.75.

In mid-August Value Line analyst Alan G. House projected 14.5-percent long-term annual earnings growth for the company, with diluted EPS (excluding special items) of $3.00 for fiscal 2004 and $3.30 for fiscal 2005. Yahoo! Finance reported analysts from 16 institutions follow the stock. Their consensus estimate was for an annual rate of earnings growth averaging 16 percent over the next five years.

Based on EPS totaling $2.88 for the four quarters ended Sept. 30, 2004, the price-earnings ratio was 20.8 in mid-November. With Value Line's projected EPS of $3.00 for fiscal 2004, the P/E would be 19.9 at the recent share price. With projected EPS of $3.30 for fiscal 2005, the P/E becomes 18.1.

Featured Resources
Editor's note: Company and industry references and their Internet links can be found in the version of this article on the NAIC Web Site.

The company has been popular among NAIC investors for a long time. Harley-Davidson joined the magazine's Top 200 list in 1994 at No. 200. Since then the stock has climbed in the rankings.

In BI's latest Top 100 survey, Harley-Davidson came in at No. 8 for 2003, with a projected 4,882 clubs having the stock among their holdings. In last year's Top 100 survey for 2002, the company was No. 12 in the rankings, again with 4,882 clubs estimated to own its shares. Harley-Davidson appeared in BI as the Stock to Study in May 2003, when its share price was $39.83.

Harley-Davidson has been prominent on BI's monthly surveys of the 10 most actively traded stocks, with participating clubs almost exclusively reporting buys. The company stayed on the list from March 2003 to April 2004, climbing to No. 1 in September and October 2003. It also appeared in June and July 2004.

The U.S. trade association for the business is the Motorcycle Industry Council. For recent statistics, see the press release "Motorcycle Sales Rev Up for 11th Straight Year" at the council's Media page.

Harley-Davidson, Inc. (www.harley-davidson.com), is traded on the New York Stock Exchange under the symbol HDI. For more information, contact Patrick Davidson (no relation to the family of the co-founders), Director of Investor Relations, Harley-Davidson, Inc., 3700 W. Juneau Ave., Milwaukee, WI 53201-0653.

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