



Mercury Foreign Desk

Polaris Inc. – Powering Strong Returns on Capital

Bloomberg: PII:US | **Reuters:** PII.N | **NYSE:** PII

In this edition of Mercury's Foreign Desk we will be covering NYSE-listed Polaris Inc., a major player in the powersports space which is a sub-sector that is unavailable in Malaysia.

Economic, Market, & Industry Overview

The Federal Open Market Committee (FOMC) expects robust 2021 GDP growth of 5.9%, albeit a reduction from the previously forecasted expansion of 7%. The FOMC has also upgraded 2022 GDP growth estimate to 3.8% from 3.3% previously, and expects an expansion of 2.5% in 2023.

Despite the downgrade in GDP growth for 2021, we think that rising wages and at least USD2.5 trillion in excess savings (source: Reuters) could provide support for consumer discretionary spending which includes power sports vehicles.

Moving on to market valuation, the S&P 500 has a relatively lofty valuation with 12-month forward PER of 26.7x compared to 15.6x for the KLCI index. However, the S&P 500 Consumer Discretionary Sector's 12-month forward PER of 30.0x is relatively cheaper compared to Bursa Malaysia Consumer sector's higher forward PER of 51.8x which is partly due to MR. DIY's high valuation.

Polaris Inc. has a significantly more attractive forward PER of 16.3x based on our estimate of FY22 EPS.

The global powersports market is expected to grow at a reasonably healthy compounded annual growth rate of 5.5% in the 2020-2027 period from USD8.8bn in 2020 to USD12.8bn in 2027 (source: Fortune Business Insights). Growth is expected to be driven by demand for accessories, increased adoption of all-terrain vehicles, and growth in snowmobiling (source: Fortune Business Insights).

NYSE
CONSUMER DISCRETIONARY
BUY
TP: USD146.26
Price: USD126.38

Business Overview

Polaris Inc. is engaged in the manufacturing of powersports vehicles namely snowmobiles, off-road vehicles (ORV), motorcycles, boats, and parts, garments & accessories. The Group's portfolio of brands include Polaris Snowmobiles, Indian Motorcycle, RZR off-road vehicles, and Bennington boats.

Polaris' products are sold through a network of approximately 2,300 independent dealers in North America, approximately 1,400 independent international dealers through over 30 subsidiaries, and approximately 90 independent distributors in over 120 countries outside of North America.

Bursa Malaysia Indices	Current PER	12-mth Fwd PER
KLCI	15.6	15.6
Finance	14.4	10.8
Property	8.8	17.4
Plantation	14.4	18.2
Consumer	-	51.8
Technology	48.0	40.5
Construction	8.1	16.7
Energy	29.2	27.3
Healthcare	5.8	10.3
Ind Prod	21.4	9.7
REIT	55.0	21.5
Telco	29.3	22.1
Transportations	55.5	26.1
Utilities	17.8	13.9

S&P 500 Indices	Current PER	12-mth Fwd PER
S&P 500	26.7	21.2
Information Technology	34.2	26.9
Health Care	22.6	16.9
Financials	14.3	15.6
Consumer Discretionary	39.8	30.0
Communication Services	-	35.8
Industrials	35.9	21.7
Consumer Staples	21.9	20.5
Energy	44.6	12.5
Utilities	20.3	20.0
Real Estate	59.8	50.3
Materials	22.7	16.1

Source: Bloomberg



Valuation / Recommendation

We have a BUY recommendation on Polaris Inc. with a price target of USD146.26 derived from a forward PER of 20.0x and FY21F EPS of USD7.31. We think that Polaris deserves a higher valuation due to the respectable growth of the industry as well as Polaris' position as a market leader. We are also excited about the potential for electric powersports vehicles to further electrify industry growth as the new slate of electric vehicles (EVs) attract new first-time consumers.

Investment Insights

Strong brand portfolio creates an economic moat that supports commendable profitability. Due to its well-established brands, Polaris has been able to achieve steady revenue growth and resilient profitability. This has allowed the Group to employ an efficient capital structure that helped it deliver impressive ttm ROAE of 70.2%.

Polaris' growing portfolio of EVs is expected to create excitement for its products and drive growth. Sales of powersports EVs are expected to grow at a significantly faster pace than the powersports industry as a whole. For instance, the global electric all-terrain vehicle and utility task vehicle (UTV) market is expected to expand at a CAGR of 23.37% in the 2020 to 2030 period to reach USD4.3bn (source: BIS Research). We think that Polaris' pipeline of EVs such as the new full-size electric RANGER UTV to be launched in December 2021 provides it with the opportunity to establish a strong foothold in the attractive powersports EV industry segment.

Low inventory levels expected to support sales in the short-term as dealers attempt to rebuild their inventory. Due to supply chain constraints and strong demand, dealer inventories in North America have declined significantly. Off-road vehicle, snowmobile, and motorcycle inventory levels at North American dealers in 2Q21 has declined by 85%, 45% and 65% respectively compared to 2Q19 levels.

Track record of rewarding shareholders. The Group's capital-light business model allows it to return significant capital to shareholders without sacrificing growth. In 2021, Polaris increased its dividend for a 26th consecutive year. If the quarterly dividend is maintained at USD0.63 per share, Polaris will have a dividend yield of 2.0% based on FY21 dividends. Additionally, the Group has a buyback yield of 5.3% based on USD410.5m spent on share buybacks in 1H21 (assuming there are no additional share buybacks in FY21).

Risk factors. Supply chain constraints could negatively impact revenue and profitability of Polaris. Demand for powersports vehicles could decline in the event that the economic recovery falters, specifically in North America where the Group generates the bulk of its revenue.

KEY STATISTICS	FY18A	FY19A	FY20A	FY21F	FY22F
Revenue (RM m)	6,078.5	6,782.5	7,027.9	7,414.4	7,822.2
Adjusted EBITDA	511.6	721.8	855.0	863.6	898.1
PATMI	335.3	324.0	124.8	448.3	474.8
EPS (USD)	5.36	5.27	2.02	7.31	7.75
EPS Growth (%)	95.6	(1.7)	(61.7)	262.0	5.9
PE (x)	12.4	17.5	62.6	17.3	16.3
Gross Dividend Yield (%)	3.1	2.4	2.0	2.0	2.0
Net Gearing (x)/ (net cash)	2.1	1.4	0.7	0.7	0.4
ROAA (%)	9.3	7.6	2.8	9.7	10.1
ROAE (%)	37.3	32.8	11.1	37.4	34.3
NA per share	13.9	18.0	18.5	20.5	24.7

Sources: Company, Mercury Securities

Stock Return Information

S&P 500	4,536.19
Expected Share Return (%)	15.7%
Expected Gross Dividend Yield (%)*	2.0%
Expected Total Gross Return (%)	17.7%
*Dividends paid by US companies are subject to 30% withholding tax	

Share Information

Market Cap (USD bn)	7.7
Issued Shares (m)	61.3
52W High (USD)	147.73
52W Low (USD)	88.68
Estimated Free Float (%)	93.2%
Adjusted Beta vs S&P 500	1.39
65-Day Average Vol. ('000)	643

Top 3 Shareholders (%)

Vanguard Group Inc	11.77
BlackRock Inc	8.01
Polaris Industries ESOP	5.35

Price Performance	1M	3M	12M
Absolute (%)	7.9	(5.8)	35.2
Relative to S&P 500 (%)	3.8	(10.8)	3.5



Source: Bloomberg



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Revenue by Products	FY18	FY19	FY20	1H21
ORV & Snowmobiles	3,919.4	4,209.10	4,533.3	2,546.50
Motorcycles	545.6	584.1	581.7	377.3
Global Adjacent Makets	444.6	461.3	424.6	278.9
Boats	279.7	621.3	603.4	396.3
Aftermarket	889.2	906.7	884.9	469.3
ORV/Snowmobiles	3,919.4	4,209.10	4,533.3	2,546.5
Motorcycles	545.6	584.1	581.7	377.3
Global Adjacent Makets	444.6	461.3	424.6	278.9
Boats	279.7	621.3	603.4	396.3

Revenue by Geography	FY18	FY19	FY20	1H21
United States	4883.8	5,551.7	5,791.1	3,185.2
Canada	390.2	394.8	396.1	284.0
Other Countries	804.5	836.0	840.7	599.1

Source: Company, Mercury Securities

Peer Comparison														
Company	Share Price	Mkt Cap (USD 'Bn)	Rev Growth %		EPS Growth		Adjusted EPS		PER (x)		ROE (%)		Div Yield (%)	
			FY21F	FY 22F	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F	FY21F	FY22F
Polaris Inc.	126.38	7.7	5.5	5.5	262.0	5.9	7.31	7.75	17.3	16.3	35.8	31.4	2.0	2.0
Harley-Davidson, Inc.	36.57	5.6	8.6	8.2	359.5	5.0	3.54	3.72	10.34	9.84	28.0	22.3	1.5	1.9
Brunswick Corporation	97.72	7.6	31.8	8.9	59.4	11.9	8.08	9.04	12.1	10.8	36.7	31.7	1.3	1.4
BRP Inc.*	114.94	9.3	31.5	10.7	75.7	9.5	9.47	10.36	12.1	11.1	-	446.8	0.4	0.4

*BRP Inc. share price, mkt cap, and adjusted EPS are in Canadian Dollars. Data for BRP are for FY22 and FY23.

Source: Bloomberg, Mercury Securities

RESULTS (USD m) FY Dec	2Q20	1Q21	2Q21	y-o-y %	q-o-q %	1H20	1H21	y-o-y %
Revenue	1511.8	1951.1	2117.2	40.0	8.5	2917.0	4068.3	39.5
EBITDA	(230.7)	243.8	273.3	n.a.	12.1	(162.8)	517.1	n.a.
Depn & Amortization	64.7	59.6	58.7	-	-	127.1	118.3	-
EBIT	(295.4)	184.2	214.6	n.a.	16.5	(289.9)	398.8	n.a.
Finance Costs	(17.9)	(11.5)	(10.7)	-	-	(34.1)	(22.2)	-
Profit Before Tax	(314.1)	175.2	207.1	n.a.	18.2	(325.7)	382.3	n.a.
Impairments	(379.2)	-	-	-	-	(379.2)	-	-
PBT Excluding Exceptional Items	65.1	175.2	207.1	218.1	18.2	53.5	382.3	614.6
Tax	78.7	(41.0)	(48.6)	-	-	84.9	(89.6)	-
Net Profit	(235.4)	134.2	158.5	n.a.	18.1	(240.8)	292.7	-
Minority Interests	-	(0.1)	(0.1)	-	-	-	(0.2)	-
PATMI	(235.4)	134.1	158.4	n.a.	18.1	(240.8)	292.50	n.a.
Basic EPS (USD)	(3.82)	2.16	2.58	n.a.	19.4	(3.9)	4.75	n.a.
Diluted EPS (USD)	(3.82)	2.11	2.5	n.a.	19.4	(3.9)	4.63	n.a.

Source: Company, Mercury Securities



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PROFIT & LOSS (USD m)	FY18A	FY19A	FY20A	FY21F	FY22F
Revenue	6078.5	6782.5	7027.9	7414.4	7822.2
Gross Profit	1501.2	1648.8	1710.2	2116.5	2232.9
Adjusted EBITDA	511.6	721.8	855.0	863.6	898.1
Depreciation & Amortisation	211.0	234.5	260.7	236.6	236.6
EBIT	487.4	483.7	212.3	627.0	661.5
Interest Expense	(57.0)	(77.6)	(66.7)	(44.4)	(44.4)
Profit Before Tax	429.2	407.8	141.4	582.6	617.1
Exceptional Items/(Loss)	(24.2)	(3.6)	(382.0)	-	-
Profit Before Tax (excl. exceptional items)	453.4	404.2	523.4	582.6	617.1
Taxation	(93.9)	(83.9)	(16.5)	(134.0)	(141.9)
Net profit	335.3	323.9	124.9	448.6	475.1
PATMI	335.3	324.0	124.8	448.3	474.8
BALANCE SHEET (USD m)	FY18A	FY19A	FY20A	FY21F	FY22F
Cash & Equivalents	161.2	157.1	634.7	377.9	699.0
Trade Receivables	197.1	190.4	257.2	220.3	232.4
Inventories	969.5	1121.1	1177.6	1514.9	1310.7
Prepaid Expenses and Other	121.5	125.9	134.1	109.1	149.3
Income Taxes Receivable	36.5	32.5	3.9	0.3	0.3
Current Assets	1485.7	1627.0	2207.5	2222.5	2391.7
Property and Equipment	843.1	899.8	888.8	897.9	891.50
Investment in Finance Affiliate	92.1	110.6	59.4	71.0	82.77
Deferred Tax Assets	87.5	93.3	177.7	159.2	159.2
Goodwill and Other Intangible Assets	1517.6	1490.2	1083.7	1063.9	1063.9
Operating Lease Assets	-	110.2	125.4	123.9	123.9
Other Non-Current Assets	99.0	99.4	90.2	93.3	93.3
Non-Current Assets	2639.2	2803.5	2425.2	2409.2	2414.6
Current Portion of Debt, Finance Lease Obligations and Notes Payable	66.5	166.7	142.1	56.1	60.5
Accounts Payable	346.3	450.2	782.2	899.3	870.6
Accrued Expenses	780.0	870.3	908.4	799.1	799.1
Other Current Liabilities	4.5	40.8	56.7	70.6	70.6
Current Liabilities	1,197.4	1,528.0	1,889.4	1,825.1	1800.8
Long-term Debt	1,879.9	1,512.0	1,293.9	1,235.3	1,180.7
Other Non-Current Liabilities	173.8	268.7	292.3	304.1	302.6
Non-current Liabilities	2,053.7	1,780.7	1,586.2	1,539.4	1,483.3
Deferred Compensation	6.8	13.6	12.3	11.9	11.9
Shareholders' Equity	866.7	1108.0	1144.5	1253.7	1512.8
Minority Interests	0.3	0.2	0.3	1.9	2.2
Total Equity	867.0	1108.2	1144.8	1255.6	1515.0
CASH FLOW (USD m)	FY18A	FY19A	FY20A	FY21F	FY22F
Net profit	335.3	323.9	124.9	448.6	475.1
Depreciation & Amortization	211.0	234.5	260.7	236.6	236.6
Impairment	24.2	3.6	382.0	-	-
Non-Cash Compensation	64.0	75.0	65.3	65.3	65.3
Deferred Income Taxes	23.4	(9.5)	(83.7)	18.7	-
Other Operating Cash Flows	(38.6)	(30.9)	(19.4)	(34.3)	(34.3)
Change in Working Capital	(142.2)	58.5	288.8	(255.0)	123.2
Cash Flow From Operations	477.1	655.1	1018.6	479.9	866.0
CAPEX	(225.4)	(251.4)	(213.9)	(230.2)	(230.2)
Distributions From Finance Affiliate	39.1	30.8	100.4	42.5	42.5
Other Investing Cash Flows	(773.2)	(18.7)	(37.2)	(19.9)	(19.9)
Cash Flow From Investing	(959.5)	(239.3)	(150.7)	(207.6)	(207.6)
Debt Raised/(repaid)	973.7	(270.0)	(246.2)	(145.7)	(56.1)
Repurchase and Retirement of Common Shares	(348.7)	(8.4)	(50.3)	(410.5)	(156.4)
Dividends Paid	(149.0)	(149.1)	(152.5)	(156.0)	(156.9)
Proceeds From Stock Issuances Under Employee Plans	47.4	15.7	33.6	162.2	32.2
Cash Flow From Financing	523.4	(411.8)	(415.4)	(550.0)	(337.2)
Impact of Currency Exchange Rates on Cash Balances	(9.5)	(0.8)	8.7	(1.9)	-
Net Increase/Decrease in Cash & Cash Equivalents	31.5	3.2	461.2	(279.6)	321.2
Cash & Cash Equivalents at Beginning of Financial Year	161.6	193.1	196.3	657.5	377.9
Cash and Cash Equivalents at End of Financial Year	193.1	196.3	657.5	377.9	699.0

Source: Company, Mercury Securities

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SELL	Stock's total return is expected to be -10% or worse over the next 12 months (including dividend yield)

Published and printed by:

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