Polaris Industries Inc. (PII)
April Sprouts Hope, but Pandemic Hits Hard

April surprise. After a strong start to the quarter, retail collapsed as the coronavirus spread. Demand improved in April and revenue is tracking ahead of our post-outbreak model, but we continue to expect tough times ahead. Management is executing its recession playbook and working to protect dealers and preserve liquidity. As parts of the economy reopen, we are more optimistic Polaris can weather the storm, but with shares up 48% in one month (S&P 500 up 13%), we advise caution – especially as America embraces a central planning mindset.

- Results. Revenue matched consensus expectations, but adjusted EPS fell short ($0.22 vs. $0.55) as the pandemic unfolded.
- Pandemic response. Polaris has taken aggressive steps to respond to the pandemic, including dealer support, cost reductions, and liquidity preservation. CFO Mike Speetzen said, “Just to be clear, even as we model downside scenarios for Q2 given the COVID-19 and current economic landscape, we do not anticipate any concerns with liquidity.” Management hopes to retain the dividend but asked the board to delay declaration until May.
- Retail. Prior to the outbreak, North American retail was tracking ahead of expectations (+5%), then fell 40% in the last two weeks of March as consumers stayed home. Shockingly, April demand is up through yesterday including roughly 15% ORV growth. MarineMax reported similar boat trends, but we are reluctant to build our models around a few weeks of good news during a pandemic/recession. Still, more than 85% of dealers are now open in some capacity as parts of the country begin to reopen.
- Dealer support. Our checks indicate dealers appreciate proactive support from Polaris, banks, and government programs. “Polaris really stepped up to the plate - waived interest on ORV until May 31 and removed spring goals.” We expect efforts to protect dealers will pay off once the crisis fades and believe Polaris is among the leaders.
- Outlook. We are concerned with the state of the American economy. The pandemic and measures to prevent the spread have forced dealers to close and consumers to stay at home. Once the outbreak subsides, consumers will have less discretionary income during what is likely to be deep and prolonged recession. Along the way, we have all become central planners, collectively deciding when to reopen the economy, which businesses deserve subsidies, and whose job is essential. From the outset of the pandemic, our options were limited. But to the extent our wealth and prosperity are the result of free markets, discretionary spending may be under pressure. Still, we believe Polaris has the right team to lead through this crisis and applaud efforts to support dealers, reduce costs, and preserve liquidity – and expect it to be among the winners when the crisis fades. But with the stock up 46% in the last month ahead of a difficult period, we advise caution.

Polaris is a powersports and marine leader. It manufactures and markets SSVs, ATVs, snowmobiles, motorcycles, small vehicles, and boats for work, play, and the military.
Details

Estimates

We raised our 2020 adjusted EPS estimate to $2.90 from $1.90 and our 2021 adjusted EPS to $5.10 from $4.20.

Polaris Initial Guidance vs. Actual Results

*2020 actual EPS reflects current Baird estimate
Source: FactSet, Company data, Baird research

Current Topics

COVID-19. Management summarized actions taken in response to the COVID-19 pandemic. Recall the company withdrew guidance and suspended production on March 23 and announced additional cost saving actions on March 31. In its Q1 earnings release, the company presented the table below highlighting actions taken.

### COVID-19 Response Actions To-Date

<table>
<thead>
<tr>
<th>Category</th>
<th>Actions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td>Reduce working capital</td>
</tr>
<tr>
<td></td>
<td>Postpone capital expenditures / tooling</td>
</tr>
<tr>
<td></td>
<td>Expand line of credit</td>
</tr>
<tr>
<td>Operations</td>
<td>Accelerating Sunburst savings</td>
</tr>
<tr>
<td></td>
<td>Organizational realignment</td>
</tr>
<tr>
<td></td>
<td>Plant optimizations / shutdowns</td>
</tr>
<tr>
<td></td>
<td>Alter delivery service levels to meet demand</td>
</tr>
<tr>
<td>Engineering</td>
<td>Reduce/delay program spend</td>
</tr>
<tr>
<td></td>
<td>Evaluate key engineering programs</td>
</tr>
<tr>
<td>SG&amp;A</td>
<td>Substantially reduce discretionary spending</td>
</tr>
<tr>
<td>Strategic</td>
<td>Wind-down select businesses (Rinker, Striper, Larson FX)</td>
</tr>
</tbody>
</table>

### Actions Designed to Provide Flexibility to Withstand Crisis

Source: Company presentation

April retail. Management noted that retail started the year strong, increasing 5% in January, February and the first half of March. As the pandemic hit the United States and dealerships were forced to close, retail fell 40% in the second half of March - bringing Q1 to down 8%. However, management noted an improvement in April - with retail growth positive 3+ weeks into the month, much better than expected.

### Q1 2020 North American Powersports Retail Sales

Source: Company presentation

- Polaris Q1’20 N.A. retail down 8%
- N.A. powersports industry retail down 9% in Q1
- Boats SSI™ Industry up 0.4%
- April retail trending much better than expected

Strong Retail Momentum Going into Final Two Weeks of March

Source: Company presentation
## Quarterly Results Variance

| Metric Variance |
|-----------------|-----------------|-----------------|-----------------|-----------------|
| Sales Metrics   | Actual 1Q20 | Estimate 1Q20E | Actual vs. Est. | Last Year 1Q19 |
| (thousands)     |              |                 |                 |                 |
| ORV/Snowmobiles | $823,700     | $804,286        | $19,414         | $867,447        |
| ORV/Snowmobile Revenue |           |                 |                 |                 |
| ORV/Snowmobile Gross Profit | $201,700     | $229,222        | ($27,522)       | $240,100        |
| ORV/Snowmobile Gross Margin | 24.5%       | 28.5%           | -400 bp         | 27.7%           |
| Motorcycles     | $126,600     | $102,746        | $23,854         | $117,942        |
| Motorcycles Revenue |          |                 |                 |                 |
| Motorcycles Gross Profit | ($300)     | ($514)          | $214            | $3,700          |
| Motorcycle Gross Margin | -0.2%      | -0.5%           | 30 bp           | 3.1%            |
| Global Adjacent Markets |             |                 |                 |                 |
| Global Adjacent Markets Revenue | $98,300     | $100,925        | ($2,625)        | $104,956        |
| Global Adjacent Markets Gross Profit | $26,900     | $27,754         | ($854)          | $29,600         |
| Global Adjacent Markets Gross Margin | 27.4%      | 27.5%           | -10 bp          | 28.2%           |
| Marine          | $154,500     | $157,089        | ($2,589)        | $184,810        |
| Boats Revenue   |              |                 |                 |                 |
| Marine Gross Profit | $29,700     | $29,061         | $639            | $36,200         |
| Marine Gross Margin | 19.2%       | 18.5%           | 70 bp           | 19.6%           |
| Other Revenue   | $202,100     | $213,919        | ($11,819)       | $220,535        |
| Aftermarket Revenue |           |                 |                 |                 |
| Aftermarket Gross Profit | $46,300     | $54,335         | ($8,035)        | $56,500         |
| Aftermarket Gross Margin | 22.9%       | 25.4%           | -250 bp         | 25.6%           |

Source: Company data, Baird research
### Estimate Variance

<table>
<thead>
<tr>
<th>Income Statement (thousands, except per share data)</th>
<th>Actual 1Q20</th>
<th>Estimate 1Q20E</th>
<th>Actual vs. Est.</th>
<th>Last Year 1Q19</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Revenue</strong></td>
<td>$1,405,200</td>
<td>$1,378,864</td>
<td>$26,236</td>
<td>$1,495,690</td>
</tr>
<tr>
<td><strong>Cost of Revenue</strong></td>
<td>$1,107,000</td>
<td>$1,054,874</td>
<td>52,126</td>
<td>$1,136,551</td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td>298,200</td>
<td>324,091</td>
<td>(25,891)</td>
<td>359,139</td>
</tr>
<tr>
<td><strong>Selling and Marketing</strong></td>
<td>$150,200</td>
<td>$128,244</td>
<td>21,956</td>
<td>$129,259</td>
</tr>
<tr>
<td><strong>Research and Development</strong></td>
<td>$78,400</td>
<td>$71,706</td>
<td>6,694</td>
<td>$67,120</td>
</tr>
<tr>
<td><strong>General and Administrative</strong></td>
<td>$68,800</td>
<td>$88,254</td>
<td>(19,454)</td>
<td>$85,449</td>
</tr>
<tr>
<td><strong>Total Operating Expenditures</strong></td>
<td>$297,400</td>
<td>$288,204</td>
<td>9,196</td>
<td>$281,828</td>
</tr>
<tr>
<td><strong>Income From Financial Services</strong></td>
<td>$19,700</td>
<td>$16,925</td>
<td>2,776</td>
<td>$18,805</td>
</tr>
<tr>
<td><strong>EBIT</strong></td>
<td>20,500</td>
<td>52,812</td>
<td>(32,312)</td>
<td>96,116</td>
</tr>
<tr>
<td><strong>Interest Expense (Income)</strong></td>
<td>$16,200</td>
<td>$16,000</td>
<td>200</td>
<td>$20,419</td>
</tr>
<tr>
<td><strong>Other Expense (Income), net</strong></td>
<td>$0</td>
<td>$0</td>
<td>900</td>
<td>($2,895)</td>
</tr>
<tr>
<td><strong>Income Before Income Taxes</strong></td>
<td>3,400</td>
<td>36,812</td>
<td>(33,412)</td>
<td>78,592</td>
</tr>
<tr>
<td><strong>Taxes</strong></td>
<td>($2,700)</td>
<td>$8,283</td>
<td>(10,983)</td>
<td>$19,390</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>6,100</td>
<td>28,529</td>
<td>(22,429)</td>
<td>59,184</td>
</tr>
<tr>
<td><strong>Adjusted EPS - Basic</strong></td>
<td>$0.10</td>
<td>$0.46</td>
<td>($0.36)</td>
<td>$1.09</td>
</tr>
<tr>
<td><strong>Adjusted EPS - Diluted</strong></td>
<td>$0.22</td>
<td>$0.56</td>
<td>($0.34)</td>
<td>$1.08</td>
</tr>
</tbody>
</table>

**GAAP Net Income**

<table>
<thead>
<tr>
<th>GAAP Net Income</th>
<th>($5,400)</th>
<th>$28,529</th>
<th>$48,378</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAAP EPS</td>
<td>($0.09)</td>
<td>$0.45</td>
<td>$0.78</td>
</tr>
</tbody>
</table>

**Basic Shares**

| Basic Shares    | 61,900   | 61,900  | 61,284  |
| Diluted Shares  | 61,900   | 63,000  | 62,027  |

**Dividend per Share**

| Dividend per Share | $0.58 | $0.58 | $0.58 |

**MARGIN**

- Gross Margin: 21.2% vs. 23.5%, -230 bp, 24.0%
- Selling and Marketing as a % of Revenue: 10.7% vs. 9.3%, 140 bp, 8.6%
- Research and Development as a % of Revenue: 5.6% vs. 5.2%, 40 bp, 4.5%
- General and Administrative as a % of Revenue: 4.9% vs. 6.4%, -150 bp, 5.7%
- Total Operating Expenses % of Sales: 21.2% vs. 20.9%, 30 bp, 16.8%
- **EBIT Margin %**: 1.5% vs. 3.8%, -240 bp, 6.4%
- Tax Rate (Applies to Polaris Income Only): -79.4% vs. 22.5%, -10190 bp, 24.7%
- Net Income Margin %: 0.4% vs. 2.1%, -160 bp, 4.0%

Source: Company data, Baird research
Quarterly Results

Q1 Highlights

- **Revenue.** Revenue decreased 6% to $1.41 billion, above our $1.38 billion estimate and in line with consensus.

- **Gross margin.** Adjusted gross margin increased 280bp YOY to 21.2%, below our estimate (23.5%).

- **EPS.** Adjusted EPS fell 80% to $0.22, below our estimate ($0.56) and consensus ($0.55).

- **North American retail sales.** Aggregate North American unit retail sales decreased 8% YOY in Q1.

- **Inventory.** Dealer inventory increased 8% during the quarter.

- **Balance sheet.** Polaris ended the quarter with $424 million in cash and $2.16 billion in debt.

Revenue.
Margin.

Gross Margin

Operating Margin

Gross Margin by Segment

Operating Expenses

Source: Company data, Baird research

EPS.

Polaris EPS Growth Attribution - LTM

Source: Company data, Baird research
North American Channel Analysis

North American retail sales.

Polaris Retail Growth
North American Units

North American dealer inventory.

Polaris Inventory Growth
North American Units

Source: Company data, Baird research
ORV/Snowmobile Segment Results

Motorcycle Segment Results
Global Adjacent Markets Segment Results

Aftermarket Segment Results

Source: Company data, Baird research

Aftermarket Gross Margin

Source: Company data, Baird research
Marine Segment Results

![Marine Gross Margin Chart]

Source: Company data, Baird research
Balance Sheet and Cash Flow

Leverage.

![Debt and Leverage Graph]

Source: Company data, Baird research

Cash flow (LTM).

![Cash Flow (LTM) Graph]

Source: Company data, Baird research
Company Strategy

Polaris 2019 Revenue Mix by Segment

- ORV/Snowmobile: 68%
- Motorcycles: 9%
- Global Adjacent Markets: 8%
- Aftermarket: 15%

Source: Company data, Baird research
Industry Overview

Polaris is a leader in the powersports industry, a 1.5 million unit market as the company defines it. Product categories include all-terrain vehicles (ATVs), side-by-side vehicles (SSVs), snowmobiles, and motorcycles.

**ORV retail market.** Based on data from a variety of sources, we estimate the worldwide ORV market (ATVs and SxSs) retailed ~900K units in 2018. The mix has shifted significantly over the past decade given the growth of the SxS market (SxS units accounted for ~60% of ORV retail in 2018 vs. ~18% at the market peak in 2005). ORV unit sales totaled just ~65% of the 2005 peak.

![Graph showing ORV industry retail sales and unit growth worldwide from 2002 to 2018.](image-url)
Survey Insights

Retail by category.

Polaris Retail Trend by Product Category
Last 5 Quarters

Retail market share.

Polaris Retail Market Share Trend by Product Category
Last 5 Quarters

Inventory.

Polaris Inventory Comfort by Product Category
Last 5 Quarters

Source: Baird research
Inventory budget.

Dealer sentiment.
Investment Thesis

Valuation. Our $75 price target is based on 14-15x our forward EPS estimate one year from now, below the five-year average (16x) as investors contemplate the impact associated with COVID-19. Over the last five years, shares of Polaris have traded from 10-23x NTM EPS, averaging 16x. Currently, shares trade at 21x our NTM EPS estimate, which reflects a period of severe pressure on earnings related to the pandemic.

Polaris is the global leader in powersports led by a deep and talented management team. The company has sustainable advantages embedded in product development, supply chain management, and distribution – often supported by lean concepts to drive faster throughput, lower costs, better share, and higher returns. Polaris has particular strength in dirt (Ranger, RZR, and Sportsman) and snow – and a growing franchise on road (Indian, Slingshot). Polaris also is building brands (Klim, Kolpin) to capitalize on the parts, accessories, and apparel opportunities created by its substantial install base. Beyond Powersports, Polaris is building capabilities to serve the commercial, military, Jeep and truck aftermarket, and small vehicle markets with brands including Brutus, TAP, Axiam Mega, Groupil, and GEM. Investment highlights include:

- Deep and talented management team that "makes growth happen"
- Market leader in powersports with plans to expand beyond powersports
- Sustainable competitive advantages built around product innovation and lean concepts

Growth drivers include:

- Transamerican Auto Parts – expanding presence in the aftermarket accessory space
- Indian Motorcycle – taking on Harley-Davidson
- Slingshot – creating a new Roadster niche
- Commercial – rethink distribution strategy to drive better sales of Brutus
- Small vehicles – develop scale by acquiring niche small vehicle brands
- Military – leverage CEO background and lower-cost products to win new business
- PG&A – leverage large install base, lean concepts and incremental distribution
- International – grow non-U.S. revenue to over one-third of business
- Armada strategy – creating niche products (e.g., ACE) to take share of dealer showrooms
- Global operations – building world-class cost structure (U.S., Mexico, Poland, India – and eventually China)
- Inventory management (MVP, RFM)

Risks & Caveats

Polaris is the leading player in an increasingly competitive powersports market. A battle for dealer showroom space creates pressure to discount product, affecting margin. Even if Polaris wins the battle, it may struggle to grow if its dealer base does not invest in expansion. Meanwhile, Polaris is taking on successful incumbents (e.g., Harley-Davidson, John Deere, Kubota, Honda) that have scale advantages. We see broad risk in economic cycles, credit cycles, and inventory cycles. Key risk factors include:

- Increasingly competitive powersports market (can require more R&D and promotional spending)
- Economic sensitivity – exposure to discretionary income, consumer confidence patterns, and the availability of consumer credit
- Exposure to the rural economy (ag prices, oil prices, land prices, etc.)
- Availability of credit (wholesale credit, retail credit – all tiers)
- Dealer inventory levels (destocking and restocking cycles)
- Dealer capacity (Polaris needs dealers to invest in larger showrooms)
- Execution risk related to diversification strategies (commercial, military, small vehicle, etc.)
- Product recalls
- Currency exposure
- Weather (e.g., snowfall)
- Free trade agreements

Company Description

Polaris Industries is a leading designer and manufacturer of powersport vehicles including ATVs, side-by-sides, snowmobiles, motorcycles, and pontoons. The company has the No. 1 share of the off-road vehicle market (ORVs), which includes ATVs and side-by-sides, is a significant player in the snowmobile market, and has a large opportunity in the motorcycle market. In 2018, Polaris entered the marine space through its acquisition of Boat Holdings. The company distributes its products through a network of independent dealers in North America and internationally.
### Baird/ Polaris Inc. - Summary Model

**Date Printed:** 4/28/2020  
**Fiscal Year End:** December  
**Recent Price:** $70.19

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</tr>
</thead>
<tbody>
<tr>
<td>($ 000s)</td>
<td>1Q18</td>
<td>2Q18</td>
<td>3Q18</td>
<td>4Q18</td>
<td>1Q19</td>
<td>2Q19</td>
<td>3Q19</td>
<td>4Q19</td>
<td>1Q20</td>
<td>2Q20E</td>
<td>3Q20E</td>
<td>4Q20E</td>
</tr>
<tr>
<td><strong>Total Net Revenue</strong></td>
<td>$1,297,394</td>
<td>$1,504,989</td>
<td>$1,653,130</td>
<td>$1,627,027</td>
<td>$1,495,690</td>
<td>$1,779,315</td>
<td>$1,771,647</td>
<td>$1,735,866</td>
<td>$1,405,200</td>
<td>$1,251,798</td>
<td>$1,484,041</td>
<td>$1,620,221</td>
</tr>
<tr>
<td><strong>Adjusted EPS</strong></td>
<td>$1.13</td>
<td>$1.77</td>
<td>$1.86</td>
<td>$1.83</td>
<td>$1.08</td>
<td>$1.73</td>
<td>$1.68</td>
<td>$1.83</td>
<td>$0.22</td>
<td>$0.46</td>
<td>$0.90</td>
<td>$1.32</td>
</tr>
<tr>
<td><strong>GAAP EPS</strong></td>
<td>$0.85</td>
<td>$1.43</td>
<td>$1.50</td>
<td>$1.47</td>
<td>$0.78</td>
<td>$1.42</td>
<td>$1.42</td>
<td>$1.58</td>
<td>($0.09)</td>
<td>$0.33</td>
<td>$0.78</td>
<td>$1.19</td>
</tr>
</tbody>
</table>

**2018** | **2019** | **2020E** | **2021E** |
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Total Net Revenue</td>
<td>$6,082,540</td>
<td>$6,782,518</td>
<td>$5,761,261</td>
</tr>
<tr>
<td>Adjusted EPS</td>
<td>$6.56</td>
<td>$6.32</td>
<td>$2.90</td>
</tr>
<tr>
<td>GAAP EPS</td>
<td>$5.24</td>
<td>$5.20</td>
<td>$2.22</td>
</tr>
</tbody>
</table>

Source: Company reports and Baird estimates  
Research disclosures can be accessed at [http://www.rwbaird.com/research-insights/research/coverage/research-disclosure.aspx](http://www.rwbaird.com/research-insights/research/coverage/research-disclosure.aspx)

Request Baird's working Excel PII Model
Appendix - Important Disclosures and Analyst Certification

Approved on 28 April 2020 19:05EDT/ Published on 28 April 2020 19:10EDT.

Rating and Price Target History for: Polaris Industries Inc. (PII) as of 04-28-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of PII.

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the next 12 months. Neutral (N) - Expected to perform in line with the broader U.S. equity market over the next 12 months. Underperform
(U) - Expected to underperform on a total return, risk-adjusted basis the broader U.S. equity market over the next 12 months.

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Company characteristics may include: stable earnings, conservative balance sheets, and an established history of revenue and earnings.
A - Average Risk – Growth situations for investors seeking capital appreciation with an emphasis on safety. Company characteristics may
include: moderate volatility, modest balance-sheet leverage, and stable patterns of revenue and earnings. H - Higher Risk – Higher-growth
situations appropriate for investors seeking capital appreciation with the acceptance of risk. Company characteristics may include:
higher balance-sheet leverage, dynamic business environments, and higher levels of earnings and price volatility. S - Speculative Risk – High
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