# Off Wall Street
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## New Rec: Briggs & Stratton (BGG: $22.78) April 22, 2014

**Position: Sell** **Target: $15.00**

| $MM | 3Q14e | 4Q14e | 1Q15e | 2Q15e | F2014e | F2015e |
|---|---|---|---|---|---|---|
| Revs | 634.8 | 514.3 | 321.5 | 421.9 | 1883.0 | 1907.6 |
| EPS $ | 0.91 | 0.34 | -0.31 | 0.08 | 0.95 | 1.11 |
| Y/Y Gr | 2% | 55% | 11% | 82% | 3% | 17% |
| PE | na | na | na | na | 23.9 | 20.5 |
| Cnsns Rev | 640.0 | 528.0 | 331.0 | 431.5 | 1907.0 | 1987.0 |
| Cnsns EPS | 0.88 | 0.49 | -0.29 | 0.10 | 1.06 | 1.34 |

**Shares Out: 48.0MM** **Market Cap: $1.09B** **FYE: June**

Concept:

1. The secular shift to electric powered mowers appears to be accelerating. BGG's walk-behinds threatened by a new line of interchangeable battery powered mowers at Lowe's, Home Depot and Sears.

2. OEMs such as Toro, Ariens and MTD are gradually replacing BGG with in-sourced or Chinese made engines.
3. After exiting the mass retail market for its branded lawn and garden products, BGG recently returned to retail with its Snapper line. However, dealers, alienated by BGG's 2013 decision to offer Snapper branded mowers at Walmart, are dropping the Snapper consumer brand.
4. Generac is gaining retail shelf space in pressure washers and portable generators. Kohler's recent entry into the portable generator market will further pressure BGG's market position.
5. Husqvarna's reduction of total number and complexity of its product platforms threatens BGG's OEM engine unit volumes in 2015 and beyond.

Summary: Briggs and Stratton (BGG) is a leading manufacturer of air-cooled gasoline engines for outdoor power equipment, with an estimated 50% global market share. The company generated sales of $1.86B in FY2013 (ended June 2013), 70% in the U.S. and the remainder from international markets, primarily in Europe. BGG reports results for two business segments, Engines (64% of revenue) and Power Products (36% of revenue). The engine segment manufactures engines primarily used to power lawn and garden equipment, including lawn mowers, snow throwers and tillers, along with other products, including generators, pumps and pressure washers. The Power Products group manufactures finished goods such as portable and standby power generators, pressure washers, snow throwers, and lawn and garden equipment with engines sourced from the Engine segment. BGG product are sold under its own brands such as Briggs & Stratton, Snapper, Simplicity, Ferris, Snapper Pro, Murray, Victa as well as under other brands such as Craftsman, John Deere, GE and Troy-Bilt.

Despite weak sales and earnings results in recent quarters, shares of BGG have benefitted from renewed investor optimism for increased growth of existing homes sales, accelerating new residential construction and more normalized weather conditions. The "street" is optimistic about the long-term prospects for BGG, believing that the company can maintain its leading market share position in engines for consumer outdoor power equipment, while exploiting new growth opportunities in light commercial outdoor power equipment and emerging markets.

We have a different view of BGG's core lawn and garden market. Our research suggests that BGG faces numerous competitive threats in both its engine and power products business segments that should negatively impact sales growth in the years ahead.

BGG's core gas powered engine business faces secular headwinds from improving eco-friendly alternatives such as electric and hybrid -powered engines. While the electric powered mower market is still a niche market in the US (about 6% market share in 2012), battery technology is improving rapidly and some new market entrants such as EGO and Greenworks now offer lithium-ion battery powered electric mowers that rival gas-powered push mowers in price, power and convenience.

With battery technology improving and prices dropping, more homeowners are considering cordless battery powered mowers. In response to increased consumer demand for battery-powered lawn and garden power equipment, major mass-market retailers such as Lowe's, Home Depot and Sears appear to have stepped up their investment in the category in 2014. In addition to dedicating more shelf-space to battery-powered lawn and garden equipment this spring, in 2014 Lowe's, Home Depot and Sears each introduced an exclusive new line of enhanced lithium-ion battery-powered mowers with an interchangeable battery for use in additional lawn and garden tools. With major mass-market retailers increasing their marketing support for lithium-ion battery powered mowers, the market for eco-friendly lawn and garden equipment is poised to accelerate in the years ahead and further challenge BGG's engine sales and market share.

Furthermore, our research suggests BGG's brand may be losing its cache with both consumers and OEM customers, especially with lower priced applications such as walk-behind mowers. Historically, many OEM and retail customers relied on BGG's strong "made in the USA" brand to win over consumers attracted to the brand's reputation for quality and reliability. Today, with more than 80% of all lawn and garden powered equipment sold in the US sold through mass merchandisers such as Home Depot, Lowe's, Sears and Wal-Mart, consumers increasingly look for bargains. Faced with continued pricing pressure from the big box retailers and its OEM customers, BGG closed down several U.S. facilities in recent years and began manufacturing or sourcing many engine components from China. With BGG and other competitors all producing comparable, low cost engines in Chinese facilities, often right next door to one another, BGG appears to have lost its ability to command a premium price for its engine product.

With engines becoming increasingly commoditized, more of BGG's major OEM customers such as Toro, Ariens and MTD are deciding to forego dual branding with Briggs and are in-sourcing lower cost engines on certain outdoor power products such as push mowers, snow throwers and tillers. We think the recent strategic moves by MTD and others to in-source engines on certain products is likely to accelerate in the years ahead, further threatening BGG's engine sales.

Based on our conversations with current and former Snapper dealers over the last year, it appears many dealers are upset with BGG's decision in 2013 to reintroduce Snapper mowers at Walmart. Many dealers with whom we spoke complained that they are suffering the brunt of consumer dissatisfaction with the low quality Snapper mowers purchased from Walmart. They say that BGG's decision to license the Snapper brand and use contract manufacturing to supply Walmart is damaging Snapper's quality brand recognition with customers. Accordingly, it appears more dealers are dropping the Snapper consumer brand, forcing BGG to increase its Snapper consumer product offering at Walmart to maintain engine unit volume. We think BGG's increasing reliance on Walmart for Snapper sales is likely to accelerate Snapper's brand erosion and puts BGG at greater risks increased pricing and margin pressure

Our fieldwork suggests that BGG is facing intensifying competition in portable generators and pressure washers from new market entrants Generac and Kohler. While Generac only entered the power washer category in late 2012, the company's products quickly won initial shelf space at major retailers like Lowe's, Sam's Club and Sears in 2013. Retail store checks indicate Generac branded power washers gained additional retail placement in 2014. Similarly, Generac's portable generators appear to be gaining display space in retail channels. In fact, Generac now claims to be the largest portable generator provider in the U.S. today, eclipsing BGG and Honda.

Following Generac's successful entry into the category, Kohler entered the portable generator market in January 2014. With Kohler branded generators rolling out to dealers in April, we think both Kohler and Generac branded SKUs remain under-distributed and further share gains versus BGG's generators and pressure washers is likely in the years ahead, as more mass dealers and retailers stock the Generac and Kohler brands.

Finally, at its Capital Markets Day (CMD) in February 2013 Husqvarna's management team unveiled a new strategic plan designed to improve corporate profitability through lower sourcing costs, price increases and the phase out of certain product platforms. While certain aspects of the plan have been delayed until 2015 and 2016, we think the medium term impact on BGG's sales as a result of Husqvarna's cost savings program is likely to be more significant than "street" bulls acknowledge.

Looking ahead, we expect revenue results at BGG to fall short of the "street's" expectations as a result of share loss and pricing pressure in engines and increased competition in pressure washers and generator products. We expect revenue of $1,883M in FY2014 and 1,908M in FY2015 as compared to "street" expectations of $1,907M and $1,987M. We forecast operating margin of 4.2% in FY2014 and 4.8% in FY2015 versus "street" consensus expectations of 4.5% and 5.5%. Finally, we expect EPS of $0.95 in FY2014 and $1.11 in FY2015 versus the "street's" forecast of $1.06 and $1.34. Our price target of $15 is approximately 13x our FY2015 EPS estimate, a slight premium to BGG's 10 year average forward year P/E and in-line with the company's estimated long-term earnings growth rate.

Borrow information: BGG

| Supply Quantity | Quantity On Loan | Available to Borrow | Date |
|---|---|---|---|
| 14.3mm | 5.3mm | 10.3mm | 4.22.2014 |

Source: Markit/Data Explorers

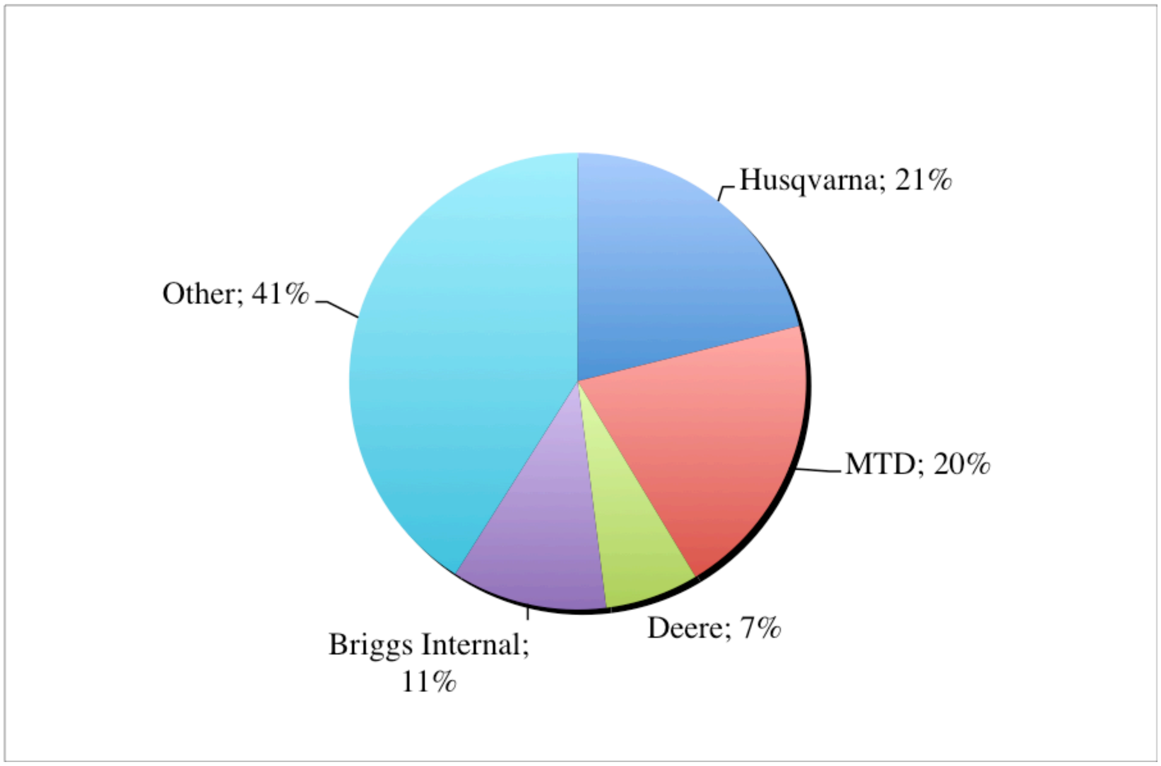


Background:

BGG's engines are used primarily by the lawn and garden equipment industry, which accounted for 86% or $1.02B of the Engine segment's FY2013 total sales. Major applications for lawn and garden equipment include walk-behind lawn mowers, riding lawn mowers, garden tillers and snow throwers. The remaining 14% ($167M) of engine sales to OEMs in FY2013 were used on outdoor power equipment for industrial, construction, agricultural and other consumer applications, including generators, pumps and pressure washers. Approximately 70% ($833M) of BGG's FY2013 Engine segment sales derived from the US market, with the remaining 30% of sales ($357M) derived from international markets, primarily Europe and Australia. The Engine segment also manufactures replacement engines and service parts for sales and service distributors worldwide. We estimate replacement engines and service parts represent about 10% of the Engine Segment's FY2013 sales ($119M) and likely have higher gross margins than the Engine segment's overall gross margin of 20.6%.

The company's engine customers are primarily outdoor power equipment OEMs, including Husqvarna Outdoor Products Group (HOP), MTD Products (MTD) Deere & Co., Global Garden Products and Toro. In FY2013 BGG's top three OEM customers represented approximately 48% of the Engine segment's sales. We estimate Husqvarna accounted for approximately 21% ($251M) of the Engine Segment's total sales, while MTD accounted for 20% ($241M) and Deere & Co. represented about 7% ($79M). In FY2013 engine sales to BGG's Products segment accounted for approximately $133M or 11% of the Engine segment's total sales.

Chart 1. Briggs & Stratton's Top Engine Customers (% of FY2013 Engine Segment Revenue)




Source: Briggs & Stratton documents, OWS estimates

BGG management estimates that the company controls approximately 50% of the $2.5B+ worldwide market for small engines that power outdoor equipment. In the US, BGG estimates it has approximately 62% market share of the top four product categories, including walk-behind mowers, riding mowers, portable generators and pressure washers. The company's major competitors in the Engine segment include Honda Motor Co., Kawasaki Heavy Industries, Kohler Co., LCT (Liquid Combustion Technology) and Loncin. One of BGG's major OEM customers, MTD, entered into a joint venture in 2006 with a major Asian manufacturing company and began in-sourcing its own engines under the Powermore brand. While BGG offers a broad spectrum of engine grades, our research suggests it competes primarily with Kohler, Honda and Loncin in entry and mid tier engine grades used on residential walk-behind and riding mowers. Alternatively, Honda, Suburu and Kawasaki brands are favored on premium engines used primarily on commercial and higher end residential mowing applications.

Prior to 2001, BGG manufactured and supplied small gasoline engines exclusively. With the acquisition of Generac Portable Products in 2001, BGG entered the generator and pressure washer products market and began to compete directly with many of its OEM customers. After 2001, BGG continued to acquire its way into the power products market with the acquisition of Simplicity in 2004 and Murray in 2005. More recently, BGG has focused its efforts on acquiring targets outside the US, including Victa Lawncare in Australia/New Zealand (2008), Premier Power in India (2011) and Branco in Brazil (2012). Today BGG's Product segment offers a full line of products, including portable and standby generators, pressure washers, snow throwers, walk-behind mowers, riding mowers, tillers and other lawn and garden equipment. BGG's products are marketed and sold under its own brands such as Briggs & Stratton, Snapper, Simplicity, Ferris, Snapper Pro, Murray, Victa as well as under other brands such as Craftsman, John Deere, GE and Troy-Bilt.

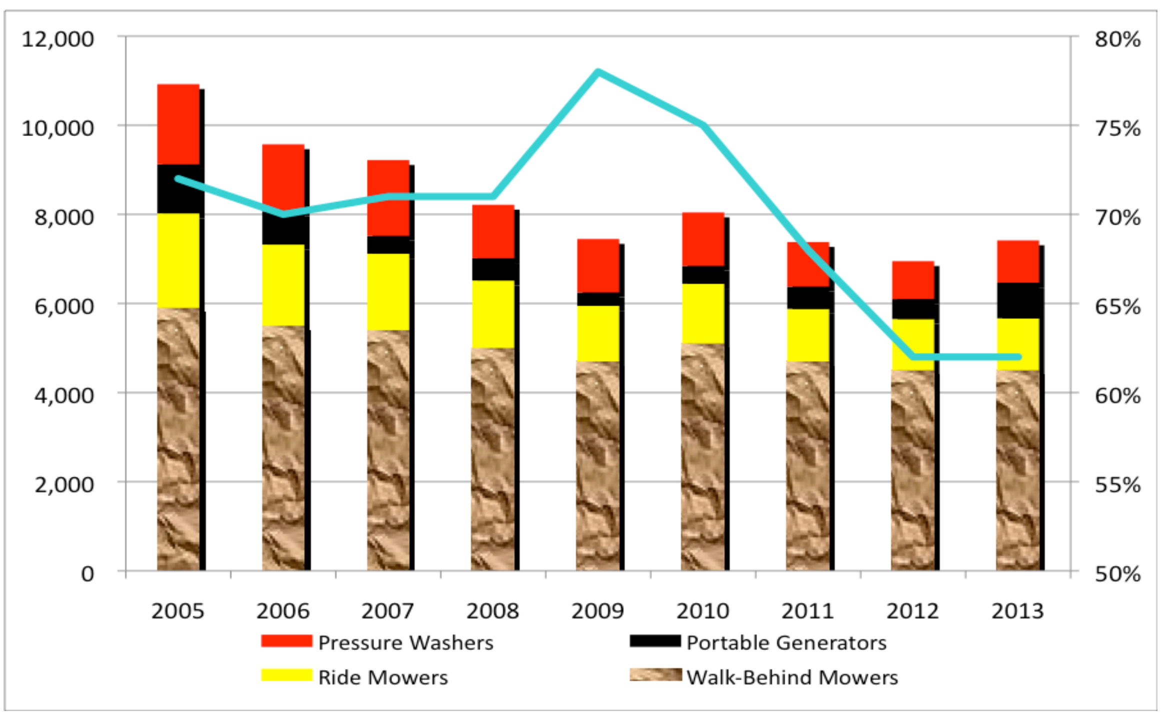
In FY2013 BGG's Product segment accounted for approximately 43% or $806M of the company's total net sales. The company's power products are generally sold directly to home centers, hardware retailers, independent dealers and mass retailers. In FY2013 sales of power products to Lowe's, Sears and Deere were approximately $226M or 28% of the Product segment's total revenue. Other major US customers include Wal-Mart, Home Depot, Tractor Supply, and a network of over 4,000 independent lawn and garden dealers. Over the last few decades, we estimate the number of major retail outlet chains for outdoor power equipment dropped from over 50 to under 15, enabling the remaining retailers to accumulate significant purchasing leverage with product suppliers like BGG and its OEM customers. According to BGG, more than 80% of all lawn and garden powered equipment sold in the US in 2013 was sold through mass merchandisers such as Home Depot, Lowe's, Sears and Wal-Mart.

We estimate BGG's various lawn and garden brands control approximately 11% or $350M of the estimated $3.0B US walk-behind and riding lawn mower market. BGG's largest OEM customer, Husqvarna, is the leader in walk-behind and riding lawn mowers with approximately 34% market share in the US. As recently as 2008/09, BGG estimated it had 50% market share of the $500M US portable generator market and approximately 50% of the $500M US market for pressure washers. Based on our research however, we think BGG's US market share in portable generators may have dropped by as much as 60% since Generac re-entered the market in 2008. Furthermore, with Generac's re-entrance into the pressure washer market in 2012 and Kohler's entry into the portable generator market in 2014, we expect BGG's market share in pressure washers and generators to decline further. The company's major competitors in the Products segment include Honda (portable generators, pressure washers and lawn and garden equipment), Generac Power Systems (portable generators, standby generators and pressure washers), Alfred Karcher GMbH & Co. (pressure washers), Techtronic Industries (pressure washers and portable generators), Deere & Co. (commercial and consumer lawn mowers), MTD (lawn and garden equipment), The Toro Co. (commercial and consumer lawn mowers), Kohler (portable generators), and Husqvarna (commercial and consumer lawn mowers).

The US consumer outdoor power equipment industry is mature, with growth largely dependent on three major factors: replacement sales, housing sales and new construction starts, and weather. After peaking in 2004 at approximately 11M units, US industry shipments of gasoline powered engines for lawn mowers, pressure washers, and portable generators decreased approximately 36% to 6.97M units in 2012, with much of the decline attributable to the decline in the housing market. Overall, major industry OEMs and independent dealers with whom we spoke expect the market for outdoor power equipment to increase 3%-5% annually over the next 3 years, driven by replacement demand and a recovery in the US housing market.

While "street" bulls expect BGG to benefit from a housing recovery and an anticipated cyclical recovery in outdoor power equipment, we note that data presented in BGG's investor presentations suggest that in the 8 years since 2005 BGG lost approximately 10% market share in the US, from 72% to 62%. Furthermore, since Tecumseh exited the engine business in 2008/09, we estimate BGG's US market share in the top four product categories dropped by more than 15% from nearly 80% to approximately 62% in 2013. As we discuss in detail below, in recent years, the emergence of Chinese-based competitors, in-sourcing by OEMs, the emergence of Generac and Kohler in certain major product markets, and enhanced environmentally friendly alternatives to gas-powered engines have led to significant market share erosion for BGG.

Chart 2. US Engine Market – Top 4 Categories (units 000's) & BGG Market Share




Source: OPEI, Briggs & Stratton data, OWS estimates

Discussion:

1. The secular shift to electric powered mowers appears to be accelerating. BGG's walk-behinds threatened by a new line of interchangeable battery powered mowers at Lowe's, Home Depot and Sears.

We think BGG's core gas powered engine business faces secular growth headwinds from improving eco-friendly alternatives such as electric, battery and hybrid -powered engines. Dealers and lawn and garden OEMs suggest the green movement, combined with higher maintenance costs and gas prices, has resulted in more homeowners considering cordless battery powered mowers. While the electric and battery powered mower market is still a niche market in the US (about 16% market share of the walk behind mower market), battery technology is improving rapidly and some new market entrants such as China-based Greenworks and EGO now offer lithium-ion battery powered electric mowers that rival gas-powered push mowers in price, power and convenience.

Up until now, the battery-powered cordless mowers on the market were either too small, had short run-times or had expensive batteries that did not last and had to be replaced often. In the spring of 2012, however, Chinese manufacturer, Greenworks introduced a lithium-ion battery powered mower that solved many of these issues. GreenWork's mower was rolled out initially at Canadian Tire but quickly gained shelf space in 2013 at Lowe's and at certain Wal-Mart, Home Depot and Sears stores. According to a GreenWork's representative with whom we spoke, the company's electric mowers promise to "bridge the gap between traditional electric and gas powered mowers."

In addition to a longer single charge run time (70 minutes vs. 30 minutes for most electric mowers), GreenWork's mower was the first to offer consumers an interchangeable or "one battery system" for all its lawn and garden products. This interchangeable battery feature was highlighted by Husqvarna at its CMD event in February 2013 as one of the foundations for future growth in the battery powered equipment market. Greenworks was the first manufacturer to achieve this milestone in 2012/2013, offering consumers the ability to alternate batteries seamlessly from a lawn mower, to a trimmer, to a chain saw to any other lawn and garden battery powered product.

As we reported in our previous BGG recommendation initiation (6/2/13), the Greenworks units appeared to be selling very well at the Lowe's stores we visited during the 2013 spring and summer selling season. Our initial observation appears to have been correct, as Lowe's decided to increase its investment in the category for the 2014 lawn and garden season. In 2014 Lowes contracted with Greenworks to manufacturer a new private label lithium-ion battery powered mower line with an interchangeable battery for use on 5 separate cordless lawn and garden tools. In February 2014, under its Kobalt private label brand, Lowe's launched a full line of 40-volt cordless outdoor power equipment including two lawn mowers, a hedge trimmer, blower, chainsaw, string trimmer/edger and a pole saw. Importantly, Lowe's Kobalt cordless outdoor power tools all operate off a single, interchangeable, 40-volt lithium ion battery system with a quick 60-minute charge time that allows for extended runtime. The new Kobalt mowers are relatively inexpensive ($349-$399) compared to alternative gas powered mowers and come with an industry leading 5-year warranty compared to 1-2 years for most gas powered mowers.

Greenworks continues to build on its early success, increasing its distribution in the retail channel and gaining retail shelf space at Lowe's, Home Depot and through Amazon.com. According to a Greenworks representative with whom we spoke, the company is building up its support and service capabilities with the intent to introduce a full line of battery-powered lawn and garden products to a dealer network across the U.S. within the next year. In addition to battery powered mowers and garden tools, Greenworks also manufactures a range of highly acclaimed corded tools, including a top selling line of pressure washers at Lowe's. At one Lowe's store, we learned that Greenwork's pressure washers were a huge success in 2013 and that the store has dedicated even more shelf space to the line in 2014.

Like Lowe's, Home Depot and Sears also launched a new, exclusive full line of cordless outdoor power equipment for the 2014 season. For 2014 Sears introduced a 20 inch cordless mower powered by the Craftsman 40-volt lithium-ion battery system. In addition to the mower, the Craftsman battery system powers a leaf blower, hedge trimmer and a trim saw. At just 42 pounds, the new Craftsman mower is very lightweight compared to traditional gas powered mowers that weigh around 70 pounds. Also, the mower is capable of holding two batteries at once and senses when one battery is depleted and automatically changes to the next for runtime up to 70 minutes before ever having to place a battery on a charger. Initially priced at $499.99, the new Craftsman mower is now being offered at Sears.com for $379.99, including 2 batteries, a charger and a 2 year warranty.

For its part, in 2014 Home Depot contracted with Chinese manufacturer EGO to launch an exclusive, new line of lithium-ion battery powered lawn and garden tools. Home Depot's EGO line includes a 20 inch lawn mower powered by the first ever 56-volt lithium-ion battery, offering 40% more power than 40-volt batteries. The new mower comes equipped with LED lights for low light mowing and has a foldable design for easier storage and cleaning. Similar to the offerings at Lowe's and Sears, Home Depot's EGO 56-volt battery system is fully interchangeable and powers a blower, string trimmer and hedge trimmer. Importantly, EGO's 56-volt battery can run off a partial charge and is fully charged in just 30 minutes. With a runtime up to 45 minutes, Home Depot's EGO is the first battery powered mower to offer a runtime greater than its charge time. At the Home Depot stores we visited, the EGO lawn and garden line had its own dedicated display shelf at the entrance of the store. Home Depot is offering the EGO mower for $499 with a 5 year warranty.

The new battery powered mower units are selling very well at the Lowe's, Sears and Home Depot stores we visited, with no reported returns. With battery technology improving and major mass market retailers now putting their full marketing support behind new, enhanced battery powered mowers and power tools, we think the market for eco-friendly lawn and garden equipment is poised to accelerate in the years ahead and further challenge BGG's engine sales and market share.

2. OEMs such as Toro, Ariens and MTD are gradually replacing BGG with in-sourced or Chinese made engines.

Our research suggests BGG's brand may be losing its cache with both consumers and OEM customers, especially with regard to lower priced applications such as walk-behind mowers. A recent study conducted by J.D. Power and Associates in 2012 revealed that 67% of customers say price was the most important consideration when selecting a walk-behind mower. Since consumers increasingly look for bargains as their purchase motivator, each year more of BGG's major OEM customers such as Deere, Toro, Ariens, Global Garden Products and MTD are foregoing dual branding with Briggs, or are in-sourcing lower cost engines on certain outdoor power products such as push mowers, snow throwers and tillers.

For example, in 2011 Deere decided to abandon its dual branding strategy with BGG on its riding mowers, preferring to replace the old Briggs logo with its own John Deere label. Even though BGG continues to provide some of the engines for Deere's consumer line of riding mowers, we think Deere's decision to forego its long time dual branding strategy with BGG is evidence that BGG's brand strength with OEMs and consumers has diminished.

As with Deere, our retail store checks indicate other major BGG customer OEMs such as Toro and Ariens are gradually weaning off BGG's engines and are increasing their use of LCT and Chinese made Loncin engines in 2014. In 2014 nearly 100% of Ariens snow throwers use LCT engines (only 1 of 23 Ariens snow throwers use a BGG engine), up from zero just a few years ago. According to an Ariens representative with whom we spoke, in recent years Ariens has increased its use of LCT and Loncin engines, particularly on its smaller units such as snow throwers, edgers and walk behind mowers. Our research indicates that Loncin now commands 33% (2 of 6 walk behind mowers) market share of Ariens walk behind mowers, up from zero just a few years ago.

Similarly, our recent retail store visits indicate that Honda, Kohler and Loncin appear to have gained market share versus BGG in walk-behind mowers in 2014. At Lowe's and Home Depot, it appears that, compared to 2013, Honda and Kohler have increased their share of engines on lower priced walk behind models under $300, particularly on walk-behind mowers made by Husqvarna and Toro. Also, Toro appears to be offering more consumer walk behind mowers with Chinese manufactured Loncin engines in 2014 compared to 2013. We estimate Loncin engines now command 38% (6 of 16 walk behind mowers) market share in Toro's walk behind mowers, equal to BGG's current market share in Toro walk-behind mowers. Since Toro only started using Loncin engines on its walk-behind mowers in 2012, we think the rapid increase in Loncin's market share with Toro should alarm BGG shareholders.

According to a study conducted by one of BGG's competitors for distribution to its own OEM customers, consumers in the market today care more about the application brand than the engine brand. For example, when Toro offers a walk-behind mower with a Toro branded engine sourced from Chinese engine manufacturer, Loncin, the customer is still apt to buy the mower because he/she views the Toro brand as a reflection of quality and durability, regardless of the engine supplier. Similarly, many dealers with whom we spoke told us that Toro's superior warranty offering (3-5 year full warranty on many Toro mowers) was more often the deciding factor for consumer purchases than the engine brand.

With this research in mind, we think it is noteworthy that BGG's second largest OEM customer, MTD (20% of BGG's engine sales), started a joint venture in 2008 with a Chinese engine manufacturer to begin in-sourcing its own engine under the Powermore, MTD, Cub Cadet and Troy Built brands. In the six years since unveiling its private label branded engines in 2008, MTD has increased their use on its lawn and garden applications (including Cub Cadet, Troy Built, MTD Gold, MTD, Yard Machines, Bolens, Yard Man and MTD Pro) from zero to ninety-three applications, representing 42% (93 of 222 platforms) of the total gas powered lawn and garden and utility vehicle platforms offered by the company, and 100% of the snow thrower category (55 of 55 gas powered snow throwers).

Our research suggests MTD is likely to accelerate its use of the Powermore engine and other Chinese made private label engines in the years ahead, further threatening BGG's engine sales. In fact, BGG's recent decision to stop producing horizontal shaft engines at its Auburn, AL manufacturing facility appears to be evidence that the company is at risk of losing market share with MTD. We note that MTD assembles push mowers and tillers at a plant located in Mississippi, less than 200 miles away from BGG's facility in Auburn, AL. Since horizontal engines are used in various gas powered lawn and garden equipment, including tillers, edgers and chippers, we suspect these product platforms are likely targets for engine in-sourcing by MTD.

While MTD's Powermore engine is already used on 100% of MTD's branded snow throwers and 83% of its log splitters, we note that since 2008 MTD also increased its use of in-sourced engines on walk-behind mowers and, more recently, on lawn and garden riding mowers. In fact, in 2013 MTD started supplying its engines for use on Craftsman lawn tractors. Following on its initial success, MTD increased its engine market share on Craftsman riders in 2014, supplying a 420cc motor on the Craftsman LT1500, 28882 and 29000 riders. Given BGG's heavy exposure to walk-behind and riding mowers, we think MTD's accelerated use of in-sourced engines on its own products and its recent emergence as a new engine supplier for retail private label brands poses a significant threat to BGG's future engine sales.

According to our analysis of MTD's 2014 product offerings, we estimate BGG commands 31% (4 of 13 gas powered tillers) market share in MTD branded tillers, 67% (2 of 3 gas powered edgers) market share in edgers, 67% (2 of 3 chippers and shredders) market share in chippers and shredders, 56% (19 of 34 gas powered push mowers) market share in push mowers, 50% (15 of 30 gas powered self-propelled mowers) market share in self-propelled mowers and 26% (10 of 39 lawn and garden riding mowers) market share in lawn and garden riding mowers.

In FY2013 MTD represented approximately 20%, or $241M of BGG's Engine segment sales. According to our analysis of MTD's 2014 product offerings, we estimate BGG's engines are used on 24% of MTD product platforms, or 54 of 222 total product platforms. Of these 54 total product lines, we estimate 52 applications are possible targets for MTD to in-source engines, including 4 tillers, 2 edgers, 2 chipper/shredders 19 push mowers, 15 self-propelled mowers and 10 lawn and garden riding mowers. While these 52 product platforms represent 96% of BGG's 54 designated product platforms with MTD, we estimate the revenue associated with these products is closer to 90% of BGG's total revenue from MTD ($217M) due to the lower ASPs associated with these products as compared to commercial zero-turn mowers. For modeling purposes, we estimate MTD in-sources 30% of BGG's product lines over the next 2 years. Accordingly, for FY2015 and FY2016 we estimate BGG will lose approximately $33M in engine revenue per year as a result of MTD's efforts to accelerate its engine in-sourcing program, eliminating nearly half of the 3%-5% annual sales growth rate anticipated by the "street" for FY2015.

3. After exiting the mass retail market for its branded lawn and garden products, BGG recently returned to retail with its Snapper line. Dealers, alienated by BGG's 2013 decision to offer Snapper branded mowers at Walmart are dropping the Snapper consumer brand.

With the distribution channel for residential outdoor power equipment increasingly dominated by national mass retailers, more lawn and garden OEMs are struggling to maintain adequate profitability in the face of constant pricing pressure from the likes of Home Depot, Lowe's and others. Rather than further jeopardize their bottom lines, some OEMs are choosing to de-emphasize the mass retail channel. For example, BGG's third largest engine customer, Deere & Co., exited the mass retail channel for walk-behind mowers and snow throwers in 2013. More recently, BGG's largest OEM customer, Husqvarna, announced its intention to follow Deere and de-emphasize the high volume mass retail channel and direct a greater percentage of the company's sales through its higher margin dealer channel.

In response to pricing and margin pressure from big box retailers, BGG exited the mass retail market for its branded lawn and garden products in 2013, sacrificing over $100M in low margin product sales to focus on the more profitable dealer channel. Unlike its OEM customer base however, BGG is an engine manufacturer with high fixed costs and can't afford to sacrifice too much engine volume without seriously risking overall company profitability. Accordingly, in 2013 BGG licensed its Snapper brand and began using a contract manufacturer, perhaps MTD, to supply Walmart with Snapper branded walk-behind mowers equipped with Briggs engines. According to BGG, the new licensing deal for Snapper is similar to the company's long standing Murray brand deal with Walmart, allowing BGG to outsource mower assembly to lower cost OEMs while BGG supplies the engines for the mower units.

Our recent conversations with current and former Snapper dealers suggest that BGG's 2013 decision to offer Snapper branded mowers at Walmart has damaged Snapper's quality brand recognition with consumers. According to dealers with whom we spoke, Snapper dealers often take the brunt of consumer dissatisfaction with high service costs and low quality mowers purchased from Walmart. As a result, dealers with whom we spoke are dropping BGG's Snapper brand leaving the brand increasingly reliant on Walmart.

In 2013, we estimate Walmart offered 17 mowers with Briggs engines (6 Murray walk-behind mowers, 6 Murray riding mowers and 5 Snapper walk behind mowers). With more Snapper dealers dropping the brand over the last year, it appears BGG arranged to offer a larger allocation of Snapper products at Walmart for the current lawn and garden selling season. Based on our analysis of Walmart's website and our recent store visits, we estimate Walmart now offers 19 mowers with Briggs engines (6 Murray walk-behind mowers, 6 Murray riding mowers, 5 Snapper walk behind mowers and 2 Snapper riding mowers).

In addition, BGG introduced a new Snapper handheld product line in 2014, including gas trimmers, a backpack leaf blower, and a hedge trimmer available at Walmart. Given BGG's decision to exit the mass retail market for lawn and garden products just last year, we find the BGG's new Snapper handheld product introduction and increased mower allocation to Walmart in 2014 puzzling. We suspect the combination of lower engine share at certain OEM customers and increased dealer exodus from the Snapper brand may be pressuring BGG to increase its Snapper mower offering at Walmart and to reintroduce lawn and garden products to the mass retail channel through Walmart. Given Walmart's buying leverage, we think BGG's increased reliance on Walmart to drive Snapper product and engine sales could lead to increased pricing pressure with negative implications for BGG's future sales and margins.

While most former Snapper dealers with whom we spoke told us that they dropped the Snapper consumer brand due to BGG's decision to reintroduce the brand at Walmart, others suggested that a recent mechanical and warranty issue with the 2013 Snapper rear engine riding mower was the "straw that broke the camel's back." According to certain dealers with whom we spoke, the 2013 Snapper rear engine rider suffered from multiple engineering and mechanical problems resulting in increased customer dissatisfaction and product returns. Other dealers told us that Briggs appeared to be moving down market to cheaper machines designed for replacement rather than annual service. Due to their growing frustration with the "cheapening" of the Snapper brand, many dealers decided to drop Snapper push mowers and replace Snapper riding mowers with Cub Cadet riders in order to attract service-related business from Tractor Supply stores that offer the Cub Cadet brand. Since Cub Cadet riding mowers use Kohler engines, we think this shift by Snapper dealers to Cub Cadet is likely to pressure Snapper product sales and BGG'e engine sales.

4. Generac is gaining retail shelf space in pressure washers and portable generators. Kohler's recent entry into the portable generator market will further pressure BGG's market position.

Our field work suggests that BGG is facing intensifying competition in portable generators and pressure washers from new market entrant, Generac. Furthermore, we think Kohler's 2014 entry into the portable generator market will further pressure BGG's market position in this core product market.

In 2008 Generac re-entered the portable home generator market after a 9-year non-compete agreement with BGG expired. Prior to Generac's re-entrance into the market in 2008, we estimate BGG controlled approximately 50% of the $300M-$600M portable generator market in the US. We note that sales of portable generators vary considerably year to year depending on weather related events such as hurricanes, snow storms, etc. For example, in 2004, just as the housing and outdoor power equipment markets reached their peaks, BGG's portable generator sales spiked in response to an unprecedented 4 hurricane land-falls on the shores of the US.

While portable generators were a source of growth for BGG during the last up-cycle through 2005, we think BGG's position in this market has diminished considerably over the last five years as a result of Generac's re-entry into the market. In fact, According to Generac, the company's market share in portable generators increased from zero in 2008 to more than 25% in 2013. Furthermore, Generac claims it continues to gain shelf space at major retailers at the expense of both BGG and Honda, the two primary market incumbents. Our retail store visits support Generac's claims, particularly with regard to Generac's liquid propane (LP) series of portable generators, which appear to be rapidly gaining display space in retail channels. As a result of Generac's in-roads, we estimate BGG's market share in portable generators may now be under 25%. We note that Generac claims to be the largest portable generator provider in the U.S. today with more than 25% market share followed by Techtronic Industries with 20%, Honda with 15%-20% and BGG with 15%-20%.

Following its successful re-entry into the portable generator market in 2008, Generac re-entered the estimated $500M pressure washer market in 2011. More recently, Generac introduced its One Wash variable speed power wash system in the Fall 2012 and quickly won initial shelf space at major retailers like Lowe's, Sam's Club and Sears for 2013. According to Generac and others, Generac increased its retail placement of pressure washers in 2014. Generac estimates that it now has low single digit market share in pressure washers and targets low to mid double digit share over the next two years.

In addition to Generac's recent arrival in the portable generator and pressure washer markets, Kohler entered the portable generator market in January 2014. According to a Kohler representative, the new Kohler portable generator line is aimed at the commercial construction market. The new Kohler line of generator products was rolled out to dealers beginning in April and will be available at retail stores sometime over the next 6 months. Industry observers expect the new Kohler series will challenge BGG's top selling Storm Responder generator series, as the new Kohler units are significantly quieter and have reduced AC power fluctuations. Since Kohler has a long and reputable history in the standby generator market, we think Kohler's new generator line represents an immediate threat to incumbents like BGG in the portable generator market.

Despite increasing gains in display, we think both Generac and Kohler branded SKUs remain under-distributed and further share gains versus BGG's generators and pressure washers are likely in the years ahead, as more dealers and mass retailers stock the Generac and Kohler brands. Furthermore, we note that both Generac and Kohler assemble their own engines for both generators and pressure washers. While Kohler is a long-time supplier of engines for commercial and consumer mowers, Generac only recently started supplying engines for Dixie Chopper for some of its commercial lawn mowers. While Generac's engine supply business makes up less than 5% of its current revenue base, management acknowledged that more opportunities to supply other lawn and garden OEMs exist, adding another potential source of risk to BGG's Engine segment.

We estimate generators and pressure washers represent about 9% or $108M of BGG's total engine unit sales and as much as 45% or $342M of BGG's total net product sales. On a consolidated basis, we estimate sales related to generators and power washers represent between 20%-25% of BGG's total sales. For modeling purposes we estimate Generac and Kohler will take 10% market share ($45M) in pressure washers and generators over the next two years. We assume half or 5% ($22.5M) of this market share loss will accrue to BGG over the next two years. We note that if Generac achieves similar success in power washers as it has in portable generators, BGG could lose as much as $50M in annual sales in this category alone, representing about 2.7% of BGG's total sales.

5. Husqvarna's reduction of total number and complexity of its product platforms threatens BGG's OEM engine unit volumes in 2015 and beyond.

At its Capital Markets Day (CMD) in February 2013 Husqvarna's management team unveiled its strategic plan to reduce product platform complexity by exiting certain platforms and de-emphasizing the mass retail channel in favor of higher margin sales into its dealer network channel. During the company's presentation of its new business strategy, Husqvarna's CEO remarked that, "the company is willing to sacrifice volume for profitability." In 2012, 75% of Husqvarna's sales derived from the retail channel compared to 25% from the dealer channel. After a delayed start in 2014 due to a change in CEO in July 2013, Husqvarna's new plan is expected to be fully implemented in 2015 with negative implications for BGG's Engine segment's unit volume and sales in 2015 and beyond.

Husqvarna's plan includes several key initiatives that pose a greater risk to BGG's future sales than "street" bulls acknowledge. First, Husqvarna plans to exit unprofitable contracts with certain retailers, brands and products. While Husqvarna's management team did not provide specifics regarding this initiative, it is clear that the company has been volume-focused in the past and has been executing on retail contracts and marketing certain brands and products that have been loss-making for the company. Going forward, Husqvarna targets a 30% reduction in product platforms. According to former CEO Hans Linnarsson, "We don't need all the products that are being sold now. We will phase out products to reduce the complexity in the production." In its most recent annual report, Husqvarna's new CEO reemphasized the company's commitment to reduce the number of brands and platforms it offers. We think Husqvarna's decision to exit these unprofitable retail contracts and product categories is likely to have a negative impact on its sales, with potential negative implications for BGG's engine unit sales.

Finally, Husqvarna outlined its ambition to lower sourcing costs. According to Husqvarna, about 42% of its sales are sourced costs, either direct materials or sourced components such as engines. According to Husqvarna, engines represent the largest component cost for the company. We estimate that in certain entry-level lawn mower categories the sourced engine component can make up nearly 50% of the total cost of the product. Through joint efforts in R&D and purchasing, Husqvarna is aiming to reduce costs in this area by 10% by 2016. In order to lower its engine costs and other sourced components, Husqvarna plans to offer suppliers a three-year contract versus the typical one-year contract. In order to win the contact however, suppliers like BGG will be required to lower prices by more than 1%-2%. During the CMD presentation, Martin Austermann, Husqvarna's Global Purchasing Officer, stated that, "we are addressing a significant message to the suppliers when it comes to prices and qualities. We are not only talking about a 1%-2% price reduction or only a 10% quality improvement, much more," implying that Husqvarna is likely to seek price concessions from BGG and other major suppliers well above 2%.

The medium term impact on BGG's sales as a result of Husqvarna's cost savings program is likely to be more significant than "street" bulls realize. After analyzing Husqvarna's 2014 lawn and garden product offerings (not including handhelds, where BGG has no presence), we estimate that Husqvarna uses BGG's engines on about 45% or 55 of its 121 total lawn and garden and industrial product applications (includes Husqvarna, Poulan, Dixon and Weed Eater brands). Accordingly, BGG is a major supplier to Husqvarna of the most costly sourced component, engines. Therefore we think BGG is likely a specific target for Husqvarna for significant price reductions, at the very least. Furthermore, since BGG's engines are on so many of Husqvarna's product platforms, we think it is likely that the company will lose some market share with Husqvarna for the upcoming 2015 season, as certain retail contracts and product platforms are exited.

Finally, since BGG is not considered to be a low cost supplier, we think the company is at risk of losing share on certain product platforms.

We note that engine placement and price discussions with OEMs typically occur between June and October for placement the following year. We estimate each percentage point of market share loss with Husqvarna represents about 38,000 units or about $5.6M in engine sales to BGG. For modeling purposes we estimate BGG will suffer a 3% decline in market share with Husqvarna and a full 2% price concession on the remaining unit volume. We note that our 2% price concession and 3% market share loss estimates could prove conservative, as many of the products in which BGG's engines are used are considered lower tier, lower priced, lower margin residential products. For example, BGG commands 59% market share (13 of 22 walk behind mowers) in Husqvarna's walk-behind mowers but just 21% market share (9 of 43 zero-turn mower) in Husqvarna's higher priced, residential and commercial zero-turn mower platforms. We think many of BGG's lower tier, lower margin consumer product platforms could be de-emphasized or eliminated by Husqvarna in the years ahead**.** We conservatively estimate that BGG's revenues with Husqvarna may drop by more than $20M in FY2015 compared to FY2014, wiping out more than a quarter of the 3%-5% sales growth rate anticipated by the "street."

6. Recent Results

BGG reported results for FY2Q14 (ended December 2013) on January 23. Total revenue of $417M (down 5% Y/Y) was below the "street's" $439M projection. BGG indicated that a lack of landed hurricanes in the quarter reduced generator sales by $55M and EPS by approximately $0.12. Non-GAAP EPS of $0.05 (down 39% Y/Y) was $0.04 below consensus. Non-GAAP earnings growth was below revenue growth primarily due to a 10% Y/Y reduction in engine unit production in the quarter due to the company's efforts to better manage inventory levels.

Management provided updated revenue guidance for FY2014 of $1.88B - $2.0B (up 1% to 7% Y/Y), with the higher side reflecting a 10%+ increase in the US lawn and garden market to be captured mostly in the fourth quarter. Management expects the U.S. lawn and garden industry to increase 4%-6% Y/Y in 2014 (the 2014 U.S. lawn and garden selling season is from September 2013 to August 2014). BGG expects sales in the company's second largest market, Europe, to be flat Y/Y while sales in Australia, BGG's third largest market, are expected to be up 4%-6% Y/Y.

BGG provided guidance for FY2014 EPS in a wide range of $1.00-$1.18. Management's FY2014 guidance includes anticipated cumulative cost savings of

$47M-$50M associated with the company's recent pension freeze and restructuring efforts. Longer term, management is targeting Engine segment operating margin in the double digits range compared to 6.2% in FY2013. For the Products segment management targets long-term operating margin in a 6%-8% range compared to -0.6% in FY2014.

7. Financial Assumptions

The "street" expects sales growth to turn positive in F3Q14 and improve steadily into FY2015 (ends June 2015). Consensus estimates call for total revenue at BGG to increase 0.5% in F3Q14 before rising 10.5% in F4Q14 and 4% FY2015 on increased sales of outdoor power equipment driven by a rebound in residential construction, a return to normal weather patterns and stable to slight improvements in market share in mowers. While few "street" models break out revenue by product line, those analysts that do provide sales by business segment forecast engine sales to increase 5% in FY2014 followed by a 5% increase in FY2015. Power product sales are expected to decline 3% in 2014 and increase 5% in FY2015. BGG's market share in its core engine market (walk and riding lawn mowers, portable generators, power washers) is expected to remain stable at approximately 65% or more in the US and 50% globally.

We expect total revenue at BGG to increase 1.1% in FY2014 and to remain essentially flat in FY2014 (up 1.3%) as a result of share loss and pricing pressure in engines and increased competition in pressure washers and generator products. Specifically, we forecast engine sales at BGG to increase 4% in FY2014 to $1.24B and to increase just 1.5% in FY2015 to $1.26B. Furthermore, we expect power product sales growth at BGG to lag "street" estimates in FY2014 and FY2015, as Generac and Kohler take market share, especially in pressure washers and generators. Accordingly, we forecast power product sales at BGG to decline 6% in FY2014 to $758M followed by a 1% increase in FY2015 to $765M.

Equally important, going forward we expect market share losses in engines and power products to dampen unit production in FY2015 and to partially offset cost benefits from recent manufacturing consolidation efforts. We also think recent unseasonably cold weather throughout much of the country and drought conditions in California likely shortened the spring selling season for BGG in FY2014, resulting in some delayed sales of lawn and garden equipment until FY1Q15 (ends September). We note that, historically, when lawn and garden sales occur late in a season, retailers are less apt to restock inventory and often postpone reorders until the following season. Accordingly, our operating profit margin estimates assume more modest operating leverage going forward for BGG.

Table 1. BGG Revenue, Margin and EPS: "Street" vs. OWS Estimates

| | FY2013a | Consensus FY2014e | Consensus FY2015e | OWS FY2014e | OWS FY2015e |
|---|---|---|---|---|---|
| Revenue ($M) | $1,863 | $1,907 | $1,987 | $1,883 | $1,908 |
| Y-o-Y % Chg | -10.0% | 2.4% | 4.2% | 1.1% | 1.3% |
| Operating Margin | 4.0% | 4.5% | 5.5% | 4.2% | 4.8% |
| EPS | $0.94 | $1.06 | $1.34 | $0.95 | $1.11 |

Source: Bloomberg, OWS Estimates

We expect revenue of $1,883M in FY2014 and 1,908M in FY2015 as compared to "street" expectations of $1,907M and $1,987M. We forecast operating margin of 4.2% in FY2014 and 4.8% in FY2015 versus "street" consensus expectations of 4.5% and 5.5%. Finally, we expect EPS of $0.95 in FY2014 and $1.11 in FY2015 versus the "street's" forecast of $1.06 and $1.34.

We note that our EPS estimate for FY3Q14 of $0.91 is $0.03 above consensus. Despite the late spring selling season in 2014, we think BGG's initial engine and product shipments may benefit from increased lawn and garden offerings at Walmart and a higher mix of lower priced Deere 100 series riders (equipped with Briggs engines) at Lowe's in 2014 compared to 2013.

## 8. Valuation

BGG's 10-year average forward year P/E multiple is 12.8x. The "street" believes that a lack of weather related events in 2013 distorted BGG's recent financial results, resulting in weaker than expected generator sales and reduced earnings guidance. With weather related weakness now in the rear view mirror, bullish analysts argue that BGG's leverage to a pending housing recovery supports a higher P/E ratio of 15x-16x. At $22.78, BGG currently trades at 17.0x consensus FY2015 EPS estimates. Our target of $15 is approximately 13x our FY2015 EPS estimate of $1.11, a slight premium to BGG's 10 year average P/E and in-line with the company's estimated long-term earnings growth rate.

## 9. Risks

On a recent quarterly conference call management stated that it would target acquisitions in the $30M - $120M range. While it is possible that BGG could make a transformative acquisition to jump start its growth outlook and profitability, we note that the company must acquire its way into emerging markets, where its brand strength is less of an advantage and where established OEMs are less prevalent. Furthermore, North America and Europe command about 90% of the worldwide market for power lawn and garden equipment, making a large, transformative acquisition in an emerging market less likely. Finally, whereas residential power equipment accounts for about 2/3rds of sales in the US, in other countries commercial outdoor power equipment is largely the focus, a segment of the market in which BGG has less of a presence.

A significant recovery in the North American housing market could allow BGG to offset somewhat some of the competitive issues we highlight in this report. That said, the majority of lawn and garden equipment is sold east of the Mississippi river and until now most of the housing related growth in the US is occurring near cities such as Phoenix, Denver and Las Vegas where lawn and garden sales typically are much less active.

Prior to FY2009, BGG did not disclose any purchase agreements in its annual SEC filings as the company relied primarily on internal manufacturing for component supply. From FY2009 through FY2012 BGG reported purchase agreements totaling \$65.3M, \$63.3M, \$61.5M and \$58.8M, respectively. In the company's FY2013 annual filing BGG reported an 86% Y/Y increase in purchase agreements to \$109.5M. We think the increase in BGG's purchase agreements likely represents one of three possibilities; 1.) BGG signed a new, large customer contract for FY2014, requiring the company to stock up on component parts; 2.) Component supplies are tight and BGG's suppliers are requiring larger purchase commitments from BGG to supply components; of 3.) Pricing pressure is intensifying and BGG is being forced to sign larger purchase commitments in order to secure better terms with suppliers. Since neither BGG's sales guidance nor our channel checks indicate that BGG won a large, new contract for FY2014, we think the most likely reason for the Y/Y increase in purchase agreements is that pricing pressure has intensified.

## 10. Financial Projections

| Qtrly Income Statement ($MM) | 2Q14a | 3Q14e | 4Q14e | 1Q15e | 2Q15e | 3Q15e |
|---|---|---|---|---|---|---|
| Net Sales | 416.6 | 634.8 | 514.3 | 321.5 | 421.9 | 643.2 |
| COGS | 337.3 | 495.6 | 415.3 | 273.4 | 342.7 | 502.1 |
| SG&A | 71.8 | 72.5 | 72.1 | 67.0 | 70.5 | 70.0 |
| D&A | 13.9 | 13.9 | 13.9 | 13.4 | 13.4 | 13.4 |
| Operating Inc | 7.5 | 66.7 | 26.8 | (18.9) | 8.7 | 71.2 |
| EBITDA | 21.4 | 80.6 | 40.7 | (5.5) | 22.0 | 84.5 |
| Interest Exp | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 | 4.6 |
| Non-Op (Inc)/Loss | 0.6 | (1.5) | (1.5) | (1.5) | (1.5) | (1.5) |
| Extra Inc | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax Income | 2.3 | 63.6 | 23.7 | (22.0) | 5.6 | 68.1 |
| Income Tax | 1.6 | 19.7 | 7.3 | (7.0) | 1.8 | 21.8 |
| Min Interest | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income | 0.7 | 43.9 | 16.4 | (15.0) | 3.8 | 46.3 |
| Diluted EPS | $0.04 | $0.91 | $0.34 | ($0.31) | $0.08 | $0.96 |
| F.D. Shares | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 | 48.0 |

| Y/Y % Change | 2Q14a | 3Q14e | 4Q14e | 1Q15e | 2Q15e | 3Q15e |
|---|---|---|---|---|---|---|
| Sales | -5.1% | -0.4% | 7.8% | 1.3% | 1.3% | 1.3% |
| COGS | -6.0% | -1.6% | 6.0% | 1.3% | 1.6% | 1.3% |
| SG&A | 3.7% | 2.6% | 2.1% | -2.6% | -1.8% | -3.4% |
| EBITDA | -14.5% | 5.9% | 39.1% | 26.0% | 3.1% | 4.9% |
| Operating Inc | -31.4% | 6.3% | 82.0% | 11.5% | 15.9% | 6.7% |
| Net Income | 210.6% | 14.0% | 129.7% | 22.7% | 439.5% | 5.4% |
| EPS | -45.9% | 2.8% | -10.0% | 11.0% | 82.3% | 5.4% |

| As a % of Sales | 2Q14a | 3Q14e | 4Q14e | 1Q15e | 2Q15e | 3Q15e |
|---|---|---|---|---|---|---|
| Sales | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| COGS | 81.0% | 78.1% | 80.8% | 85.0% | 81.2% | 78.1% |
| Gross Profit | 19.0% | 21.9% | 19.2% | 15.0% | 18.8% | 21.9% |
| SG&A | 17.2% | 11.4% | 14.0% | 20.8% | 16.7% | 10.9% |
| EBITDA | 5.1% | 12.7% | 7.9% | -1.7% | 5.2% | 13.1% |
| Oper Inc | 1.8% | 10.5% | 5.2% | -5.9% | 2.1% | 11.1% |
| PreTax Inc | 0.6% | 10.0% | 4.6% | -6.8% | 1.3% | 10.6% |
| Tax Rate | 69.8% | 31.0% | 31.0% | 32.0% | 32.0% | 32.0% |
| Net Inc | 0.2% | 6.9% | 3.2% | -4.6% | 0.9% | 7.2% |

| Annual Income Statement ($MM) | FY10 | FY11 | FY12 | FY13 | FY14e | FY15e |
|---|---|---|---|---|---|---|
| Net Sales | 2,027.9 | 2,110.0 | 2,066.5 | 1,862.5 | 1,883.0 | 1,907.6 |
| COGS | 1,647.9 | 1,711.7 | 1,685.0 | 1,514.6 | 1,518.1 | 1,538.9 |
| SG&A | 280.2 | 300.7 | 290.4 | 276.2 | 285.2 | 277.8 |
| D&A | 66.2 | 61.8 | 63.7 | 55.8 | 54.8 | 53.4 |
| Operating Inc | 99.7 | 97.7 | 91.1 | 71.7 | 79.7 | 90.9 |
| EBITDA | 165.9 | 159.5 | 154.8 | 127.5 | 134.5 | 144.3 |
| Interest Expense | 26.5 | 23.3 | 18.5 | 18.5 | 18.4 | 18.4 |
| Non-Oper Inc | 24.1 | 42.3 | 42.7 | 105.3 | -0.9 | -6.0 |
| Extra Inc | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Pretax Income | 49.1 | 32.1 | 29.9 | -52.1 | 62.3 | 78.5 |
| Income Tax | 12.5 | 7.7 | 0.9 | -18.5 | 20.7 | 25.1 |
| Min Interest | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Income | 36.6 | 24.4 | 29.0 | -33.7 | 41.6 | 53.4 |
| Diluted EPS | $1.10 | $1.25 | $1.24 | $0.84 | $0.95 | $1.11 |
| F.D. Shares | 50.1 | 50.4 | 49.9 | 47.2 | 47.7 | 48.0 |

| Y/Y % Change | FY10 | FY11 | FY12 | FY13 | FY14e | FY15e |
|---|---|---|---|---|---|---|
| Sales | -3.1% | 4.0% | -2.1% | -9.9% | 1.1% | 1.3% |
| COGS | -6.0% | 3.9% | -1.6% | -10.1% | 0.2% | 1.4% |
| SG&A | 5.6% | 7.3% | -3.4% | -4.9% | 3.3% | -2.6% |
| EBITDA | 17.9% | -3.9% | -2.9% | -17.7% | 5.5% | 7.3% |
| Operating Inc | 36.7% | -2.0% | -6.7% | -21.3% | 11.1% | 14.1% |
| Net Income | 14.5% | -33.5% | 19.1% | -216.0% | 223.6% | 28.3% |
| EPS | 42.9% | 13.6% | -0.8% | -32.3% | 13.0% | 17.2% |

| As a % of Sales | FY10 | FY11 | FY12 | FY13 | FY14e | FY15e |
|---|---|---|---|---|---|---|
| Net Sales | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |
| COGS | 81.3% | 81.1% | 81.5% | 81.3% | 80.6% | 80.7% |
| Gross Profit | 18.7% | 18.9% | 18.5% | 18.7% | 19.4% | 19.3% |
| SG&A | 13.8% | 14.2% | 14.1% | 14.8% | 15.1% | 14.6% |
| EBITDA | 8.2% | 7.6% | 7.5% | 6.8% | 7.1% | 7.6% |
| Oper Inc | 4.9% | 4.6% | 4.4% | 3.9% | 4.2% | 4.8% |
| Borrowing Rate | 10.8% | 10.7% | 8.1% | 8.2% | 8.2% | 8.2% |
| Rate of Return | -36.4% | -25.9% | -23.3% | -61.1% | 0.6% | 4.0% |
| PreTax Inc | 2.4% | 1.5% | 1.4% | -2.8% | 3.3% | 4.1% |
| Tax Rate | 25.4% | 24.0% | 2.9% | 35.5% | 33.2% | 32.0% |
| Net Inc | 1.8% | 1.2% | 1.4% | -1.8% | 2.2% | 2.8% |

## 11. Financial Metrics

| | |
|---|---|
| Debt & Equivalents | 431 |
| Equity | 628 |
| Tangible book | $10.04 |
| Market value | 1,089 |
| Cash | 98 |
| EV | 1,422 |

| | FY13a | FY14e | FY15e |
|---|---|---|---|
| EBITDA | 127.5 | 134.5 | 144.3 |
| Capex | 44.9 | 50.0 | 55.0 |
| Free cash flow | 128.4 | 125.5 | 110.9 |
| Dividends | 23.3 | 23.7 | 23.7 |
| CF After Divs | 105.1 | 101.8 | 87.2 |
| | | | |
| EV/EBITDA | 11.2 | 10.6 | 9.9 |
| EV/FCF | 11.1 | 11.3 | 12.8 |
| EV/Sales | 0.8 | 0.8 | 0.7 |