Polaris Industries Inc PII (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
115.34 USD	160.00 USD	96.00 USD	248.00 USD	High	Wide	Stable	Exemplary	Autos

Despite competitive industry trends, Polaris remains on solid footing due to strict cost controls.

Updated Forecasts and Estimates from 21 Oct 2015

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The primary analyst covering this company does not own its stock.

Research as of 21 Oct 2015
Estimates as of 21 Oct 2015
Pricing data through 03 Nov 2015
Rating updated as of 03 Nov 2015

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 21 Oct 2015

Polaris is one of the most respected and innovative brands in power sports. With more than 60 years of manufacturing experience, we believe the firm's brands, innovative products, and Lean manufacturing yield Polaris a wide economic moat. The company stands to capitalize on its R&D strategy, reputation for quality, operational excellence, and acquisition strategy, which have allowed it to take share from its competitors and improve profitability. However, there are no switching costs from Polaris' well-regarded brands, which will make it increasingly difficult to capture incremental share in the sizable off-road segment, especially if peers are able to come to market faster with new products than in the past and price competition does not abate.

Polaris continues to pursue improvements to better its financial condition. First, it perpetually improves on operational excellence and Lean initiatives, focusing on shorter lead times, faster turns, and better quality, driving higher profits. Second, manufacturing expansion continues, with new facilities opening in Alabama and South Dakota in 2016, which should yield savings via faster distribution and help better match supply and demand. Third, the inorganic part of the growth strategy allows for forays into new category opportunities, as with the GEM and Aixam acquisitions--with little debt on the balance sheet, the firm has financial flexibility to pursue multiple acquisitions ahead.

Polaris has a crafted a plan to grow both organically and inorganically, but doing so strategically will allow it to expand profitably. We have seen Polaris achieve this through its branding relationship with Bobcat, its acquisition of Goupil and Aixam, which have a distribution channel in Europe, and its joint venture with Eicher, among others. Finally, international expansion plans may drive revenue upside if executed properly, particularly as Polaris gains more contacts in the distribution channel overseas and increases its operating presence internationally via its newer manufacturing facilities. The company already has a presence in Europe, but there remains a longer-term opportunity in newer markets, including India and China.

Vital Statistics

Market Cap (USD Mil)	7,562
52-Week High (USD)	159.33
52-Week Low (USD)	104.10
52-Week Total Return %	-21.9
YTD Total Return %	-22.7
Last Fiscal Year End	31 Dec 2014
5-Yr Forward Revenue CAGR %	9.1
5-Yr Forward EPS CAGR %	12.1
Price/Fair Value	0.72

Valuation Summary and Forecasts

Fiscal Year:	2013	2014	2015(E)	2016(E)
Price/Earnings	27.0	22.7	*15.6*	*13.9*
EV/EBITDA	13.7	12.0	*7.8*	*7.4*
EV/EBIT	15.9	14.1	*9.7*	*9.0*
Free Cash Flow Yield %	3.3	2.4	*6.0*	*7.4*
Dividend Yield %	1.2	1.3	*1.9*	*2.4*

Financial Summary and Forecasts (USD Mil)

Fiscal Year:	2013	2014	2015(E)	2016(E)
Revenue	3,777	4,480	*4,961*	*5,394*
Revenue YoY %	17.7	18.6	*10.7*	*8.7*
EBIT	583	715	*786*	*846*
EBIT YoY %	20.0	22.6	*10.0*	*7.7*
Net Income, Adjusted	381	454	*502*	*558*
Net Income YoY %	22.0	19.2	*10.6*	*11.1*
Diluted EPS	5.40	6.65	*7.41*	*8.30*
Diluted EPS YoY %	22.7	23.3	*11.4*	*12.0*
Free Cash Flow	87	280	*456*	*521*
Free Cash Flow YoY %	-67.8	221.4	*62.8*	*14.3*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Polaris designs and manufactures off-road vehicles, including all-terrain vehicles and side-by-side vehicles for recreational and utility use, snowmobiles, small vehicles and on-road vehicles, including motorcycles and low-emission vehicles, along with the related replacement parts, garments, and accessories. These products are sold through 1,750 dealers in North America and through subsidiaries and distributors in more than 100 countries outside North America.

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Morningstar Analysis

Despite Competitive Industry Trends, Polaris Remains on Solid Footing; Shares Undervalued 21 Oct 2015

In light of foreign-exchange headwinds and competitive pricing across the powersports industry, Polaris delivered solid third-quarter results. However, the business continues to bump up against capacity constraints and work through its paint issues in the motorcycle segment, leaving a backlog in demand that is still to be worked through. We view the biggest concern to the company as the ongoing competitiveness in the sizable off-road vehicle segment (which comprised 62% of reclassified enterprise sales last year), as peers in the category aggressively discount and come to market faster with new products than in the past. We expect to take our $169 fair value estimate down modestly in response to competitive changes in the off-road category, rendering the growth rate slower than we have previously modeled. With shares trading around 13 times our 2016 estimate, we view shares as undervalued, but caution investors that there could be some uncertainty surrounding the name as industry inventory at retail is worked through, and while the firm continues to close the gap on its backlog.

Despite rising foreign-exchange headwinds, which have led to guidance for gross margins that contract 40-60 basis points for the full year (versus flat previously), Polaris has been able to maintain its fiscal 2015 earnings per share estimate, narrowing to the high end of its prior range at $7.37-$7.42 (we had $7.36 modeled), as it exercises diligent cost control across the business. Operating expenses are set to fall 50-60 basis point (20-30 basis points prior), indicating to us that management is pulling on all levers to drive value for its shareholders. The long-term strategy of the firm is intact, still focused on lean, global market leadership, 5%-8% organic growth, and net income margins above 10%. Our top-line growth assumes slightly better revenue as a result of acquisitions, and our bottom line is also modestly higher, above 11%, as we expect expenses to lever on volume.

During the quarter, total sales rose 12%, to $1.5 billion, and all categories delivered positive results, with off-road growing 3%, snowmobiles up 14%, global adjacent markets rising 10%, and motorcycles outperforming wildly, up 154% thanks to strong Slingshot and Indian performance (despite a still-significant backlog). All-terrain vehicles and side-by-sides were able to gain share (both growing at a low-single-digit pace) as the ATV industry declined slightly and the side-by-side industry delivered positive results that were slightly slower than Polaris'. Gross margins fell 130 basis points to 28.5%, with foreign exchange driving 60% of the decline, with the additional inflated costs attributable to incremental motorcycle manufacturing costs and higher promotional expenses. The company was able to offset some of this by diligently executing on costs, and the operating expense ratio fell 80 basis points year over year to 13.2%. Total dealer inventory was 14% higher than the third quarter of 2014, but off-road inventory, which had been problematic in recent periods, rose only 10% and is expected to fall to a mid-single-digit rate by the end of the year.

From our vantage point, the brand prowess that Polaris has cultivated and the operational excellence that has become a bloodline of the business still exist. We think shares have recently been unfairly punished for missteps in the evolving paint process at its motorcycle plant in Spirit Lake, Iowa, and the structurally changing landscape in the off-road segment. However, we believe the company is taking all the possible steps to rectify any concerns it can control. Polaris purchased a paint facility in Spearfish, South Dakota, earlier this week (the old Lehman Trike facility), which will add 10% paint capacity, and is upgrading processes to improve flow at Spirit Lake, which should increase paint capacity 30%, both in 2016. We don't expect all aspects of the business to run smoothly all the time, and view the paint missteps as a hiccup across otherwise very disciplined manufacturing processes at the company. With regards to off-road, we don't see changes to the competitive landscape as self-

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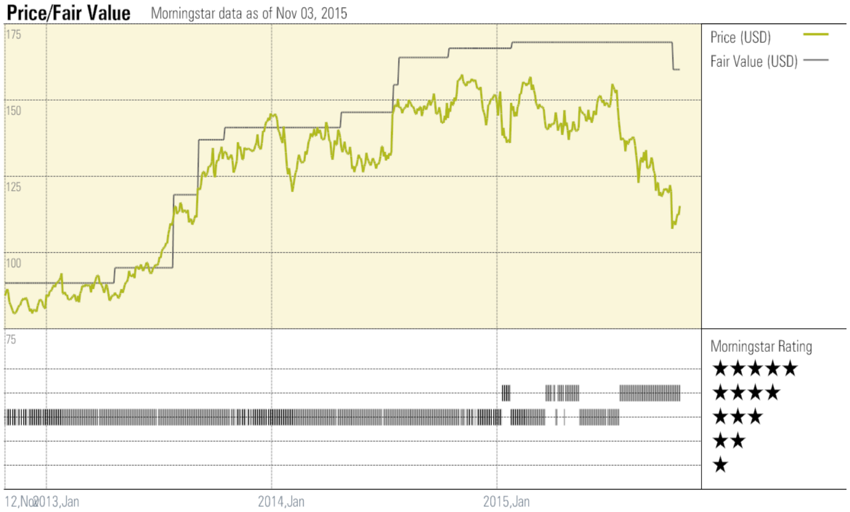
Price/Fair Value Morningstar data as of Nov 03, 2015



inflicted and think the company is still competing at the top of its class in the category. However, with other compelling products coming to market faster and peers like Arctic Cat and BRP attempting to close the gap, we do not believe challenges will abate and plan to reduce our long-term top-line growth rate for the segment by 1%-2% to account for the evolving environment.

All considered, Polaris still delivers some of the best returns on invested capital (50%) we've seen from a business across numerous sectors. With little leverage on the balance sheet and plenty of cash on hand, the firm can remain nimble, investing in innovation and acquiring adjacent businesses to grow the top line ahead. We believe peers will continue to try to close the gap, making Polaris work a little harder than it has had to in the past, but we don't see market leadership or brand degradation occurring any time soon if the company continues to deliver products that cater to consumer demands and offer entry into new categories.

Valuation, Growth and Profitability 21 Oct 2015

We are lowering our fair value estimate to $160 from $169 per share in response to competitive changes in the off road category, rendering the growth rate slower than we have modeled in the past (averaging 4.5% versus 6% previously). Our fair value estimate implies a 2016 P/E ratio of 19 times and an EV/EBITDA multiple of 12 times. This is versus a five-year historical median P/E of 21 and EV/EBITDA of 11. We still view the product lineup as the driving factor in growth ahead, with the newest product coming out of its joint venture with Eicher, Multix (a multirole personal vehicle--for family, power, and business), as indicative of Polaris' ability to create a new product with unmet demand.

We expect Polaris sales will continue to grow as long as innovation doesn't wane--as the firm maintains market share in its traditional segments and captures sales from product line expansions (like Slingshot and Multix) with previously untapped consumers. We believe sales for the off-road segment can rise at a mid-single-digit rate over the next five years, with motorcycle growth at a double-digit pace as the Indian brand captures wider market share and the Slingshot taps into new demand, while snowmobiles increase at a low-single-digit pace over the longer term. International sales should ramp faster than in the past as Polaris increases visibility overseas and expands its small vehicle business (through acquisitions), while support in the domestic market stems from a limited used market and replacement need, particularly in off-road and snowmobiles. Lower-priced off-road vehicles should continue to attract new users who we hope will trade up to a higher-margin product at the next purchase. We expect that credit will remain available to wholesale and retail channels at current levels and management will continue to acquire like-minded companies.

Polaris' gross profit margin is poised to expand moderately over the next decade, and the marketing ratio should moderate (slightly lower than the historical average of 7%). Our base case assumes that gross margins stabilize at 30.5%, which we believe is reasonable because of the continued implementation of Retail Flow Management across segments as well as stable commodity costs. Polaris has historically generated returns on invested capital well above our weighted average cost of capital assumption (8.9%), and should be able to achieve ROICs of above 50% if the competitive and macro environments remain stable.

Scenario Analysis

We have used a scenario analysis to help assess the upside and downside potential of Polaris' intrinsic value. In our positive scenario, economic stability prevails and credit standards remain flexible, which help the pricing and demand across all three product lines. We forecast revenue in off-road to grow at a high-single-digit pace, while motorcycles grow at a double-digit clip over the next five years, and snowmobiles tick up at a mid-single-digit rate on average. We have improved commodity prices and costs in 2016 and beyond, which will expand the operating margin to 19%, better than the five-year average of 14%. Marketing and selling expenses would remain at approximately 7% of sales, and research and development would represent 4% of sales in both the upside and downside case as the firm continues to allocate capital to create and promote new products. We expect interest expense to reflect the current rates on the current notes outstanding, and we do not anticipate that any material level of debt will be raised unless the company pursues a larger than usual acquisition. If the company benefits from these positive events, our fair value estimate would be $214.

In a downside case where the company encounters a macro slowdown, more difficult credit standards for retail and wholesale financing, and an increasingly competitive environment on pricing, we would expect sales to that are flat or modestly negative for off road and snowmobiles, while global adjacent markets and PG&A still capture a low-double-digit growth rate and on road nudges out low-single-digit growth. We have modeled persistence in inflation of commodity costs in our bear case, which is reflected in a cost of goods sold ratio that rises from the forecast 71% level this year to 72%. These assumptions would hold our operating margins at 14% in 2016. In our bear case, the fair value estimate would be $104.

Polaris has a high uncertainty rating, because its product lineup creates some volatility to both revenue and profits during periods of economic duress. While we believe this is declining as the company becomes more diversified, some of the more discretionary sales remain at risk, subject to swings in consumer confidence and the competitive environment.

For reference, over the past five years, Polaris' average cost of goods sold ratio was 72%, while the selling and marketing ratio was 7% and G&A was 5%. In our model, a 1% change in the cost of goods sold ratio equates to about $0.48 in 2015 earnings per share, while a 1% change in the G&A, selling and marketing, and research and development ratios equates to about $0.48 each ($1.44 total) in 2015 earnings per share.

Economic Moat

We believe that Polaris has established a wide economic moat, delivering healthy returns on invested capital (an average of 50% over the past five years. Nonexistent switching costs could weigh on pricing power intermittently. However, we believe the company's innovative product offerings and growth of adjacent categories through acquisitions (and organically) have positioned the business to continue to capture increasing volume and profits as it reaches new end users.

The company's brand has a long history. More than 60 years ago Polaris started to build its reputation and brand by producing snowmobiles. In the decades since, the company has expanded into all-terrain vehicles, motorcycles, people movers, and for a short period, personal watercraft, building

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Morningstar Analysis

a recreational and utilitarian vehicle powerhouse. Holding leading market share positions in all of the categories it operates in (the company is number one in ATVs, utility SBS, Recreational SBS, Quadricycles in Europe, ULTV for Military, and number two in snowmobiles and domestic motorcycles) has ensured the company's brand remains relevant. We believe when consumers replace (or think about purchasing) products in the snowmobile and off-road categories they tend to want the best products with the newest technology, which is what Polaris provides, yielding them stability in pricing and positive brand perception. Currently, in North America one in three power sports sales is of a Polaris product.

We believe the volume of product that Polaris manufactures and ships leads to meaningful cost leverage, as Polaris sold $4.5 billion in goods in 2014 versus and estimated $699 million for Arctic Cat (March 2015 year-end) and CAD 3.5 billion for BRP (January 2015 year-end). We think the company's cost leverage can continue to improve over time as the expansion of its brand presence overseas leads to further unit volume growth. While the relaunch of Indian in 2013 and the continued evolution of on- and off-road products (Slingshot and Ace launched in 2014) should drive domestic demand, small vehicles are set to experience robust growth overseas. Over the past few years, management has pieced together a significant stake in the global small-vehicles business, which included the acquisitions of GEM, Goupil, and Aixam Mega along with its JV product launch with Eicher in India, of the Multix. Management believes it can grow $157 million in small-vehicle sales (before reclassification, now known as Global Adjacent Markets) in 2014 to $1 billion in 2020 through a series of further acquisitions, which implies material growth in international markets. With new manufacturing facilities abroad, we could see operating efficiencies achieved with the appropriate company easily. With a distribution network already intact overseas, we can envision acquired sales rising quickly. This should boost Polaris scale faster, helping the business capture further operating efficiencies and possibly boosting operating margins higher than we currently anticipate (as Lean remains a key theme over recent years).

We think the company's economic moat is predicated on its brand strength, but low-cost production supports and strengthens its moat rating. Having competitive manufacturing facilities in strategic locations gives the company the ability to remain an efficient and low cost competitor. In 2012 the company opened its first factory in Mexico, aiding distribution in the Southwest and engaging labor at competitive rates. After that, the firm added extra capacity in Milford, Iowa (adjacencies and capacity), more space at Spirit Lake, Iowa, expanded room at Roseau for the Lean transformation, the acquired Aixam plant for people movers, a new facility for production in Poland, and and plant in Alabama and South Dakota that will be up and running in 2016. In addition, new vehicle production in India through the company's joint venture with Eicher will provide Polaris with quick distribution to the Far East (and possibly a better tariff situation), increasing the company's visibility and footprint significantly.

Moat Trend

Polaris' moat trend is stable. We think neither its dealer network nor its brand identity in off-road vehicles will be replicated by a new entrant in the near future. Similarly, the long history of quality products the firm has produced, particularly in snowmobiles and ATVs, is likely to keep the company a formidable player. However, the competitive spirit of the industry has risen persistently in recent periods and we plan to watch its impact on market share and pricing power in periods ahead to determine whether brand equity is improving or degrading. Over the near term, establishing a new dealer network would be rather difficult to achieve, which should keep the moat wide. It is possible for another

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competitor to manufacture and distribute similar products, but we believe any new competitor would find it difficult to capture market share quickly without first developing brand equity. Competitors with their own dealer networks and brand power (particularly Harley-Davidson and Honda) will be equally difficult to knock from their perch.

In order to capture a positive trend rating, we would have to see Polaris concepts continue to display consistent pricing power, product launches that respond faster to economic cycles, or a meaningful improvement in the cost structure as the company expands its manufacturing footprint globally. With the opening of the Alabama manufacturing facility in 2016, we could imagine that the saving in shipping costs could help gross and operating margins vault to new levels. However, as the firm has more disparate small facilities (for Aixam or Goupil) we could see medium-term costs tick up if Polaris attempts to consolidate some smaller facilities, especially if it continues to acquire minor players in the small-vehicle market. We believe acquisitions of less-productive businesses could weigh on operating margin expansion, as targets are likely to operate less optimally. Additionally, the ATV pricing environment remains competitive, which could prevent the company from passing through price increases easily.

To assign the company a negative moat trend, we would expect the company to experience persistent recalls of poorly manufactured products, driving consumer concern about safety and quality, ultimately indicating that brand power has receded. Additionally, if we anticipate a secular change in discretionary spending trends that would change the power sports landscape permanently, the earnings potential of the business could be tempered longer term.

Adjusted ROICs have averaged 50% over the past five years, despite weakness in some pockets of consumers domestically since the 2008 recession. We believe the company still has some tailwinds, even though it seems to be reaching critical mass with its product in the United States. Polaris can continue to grow through the following channels: international (outside of the United States and Canada) penetration (target 33% by 2018, only 15% in 2014); acquisitions in adjacent categories (GEM, Goupil, Aixam), particularly in the small-vehicle space; joint ventures (Eicher gives entry into the Indian market, while Bobcat offers reach in construction); and its key off-road vehicle market thanks to its patented product design. Our ROICs remain above 50% at the end of our explicit forecast, but could increase if the company continues to purchase businesses that are quickly accretive.

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Bulls Say/Bears Say

Bulls Say

- Polaris has a strong reputation for innovation, and new product lines along with acquisitions has supported its strong performance in both strong and difficult environments.
- Sales trends are impressive, with average annual revenue growth above 20% over the past five years, outstripping other discretionary industries.
- Management remains focused on Lean production and operating as a best-in-class manufacturer. With two new facilities slated to open in Alabama and South Dakota, continued pursuit of excellence should boost operating margins.

Bears Say

- Volatility in input costs, including commodity prices, labor, or shipping expenses, could weigh on profitability.
- Polaris competes with some formidable brand names, such as Harley-Davidson in the motorcycle industry and Arctic Cat and BRP in the snowmobile and ATV sector.
- Business is dependent on credit availability in the wholesale and retail segments. The withdrawal of any financing sources could prevent inventory from moving through the channel.

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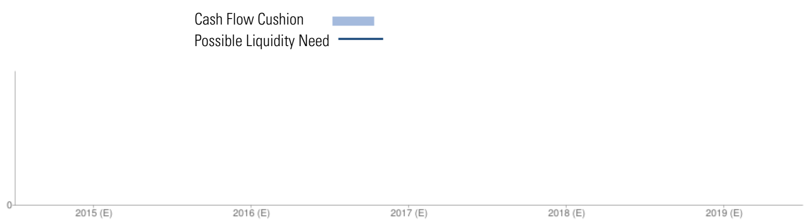
Five Year Adjusted Cash Flow Forecast (USD Mil)

	2015(E)	2016(E)	2017(E)	2018(E)	2019(E)
Cash and Equivalents (beginning of period)	92	121	436	732	935
Adjusted Available Cash Flow	—	—	—	—	—
Total Cash Available before Debt Service	444	549	885	1,209	1,465
Principal Payments	—	—	—	—	-25
Interest Payments	-11	-8	-8	-8	-8
Other Cash Obligations and Commitments	—	—	—	—	—
Total Cash Obligations and Commitments	-22	-20	-20	-21	-46

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	USD Millions	% of Commitments
Beginning Cash Balance	—	—
Sum of 5-Year Adjusted Free Cash Flow	—	—
Sum of Cash and 5-Year Cash Generation	—	—
Revolver Availability	—	—
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	—	—
Sum of 5-Year Cash Commitments	-130	—

Financial Health

In 2006 Polaris raised debt to accelerate share buybacks, lifting its debt/total capitalization ratio to about 60%, from virtually no debt beforehand. The company eventually paid down its $200 million term loan with a newer $100 million it received in unsecured notes and $100 million with cash on hand and improved profitability, reducing the debt/capital ratio from 49% in December 2009 to 19% in December 2014. The company raised $100 million through a private placement in November 2013 to help cover the expenses with the buyback of about 4 million shares from longtime manufacturing partner Fuji Heavy Industries. We like that the company has a $350 million revolver available to address the seasonality of production and shipments--although shipments are becoming closer to just-in-time than in the past, removing cyclicality in orders.

We believe Polaris' conservative levels of debt help maintain the financial strength of the company. The company is poised to produce significant cumulative free cash flow over the next five years worth almost $3.2 billion; thus, we believe the company should have no problem repaying its debt as it comes due (all of the debt has longer-term maturities). The current revolver is set to mature in 2018. The $25 million senior unsecured note (3.81%) is due in May 2018, the $75 million senior unsecured note (4.60%) is due in May 2021, and the recent $100 million private placement (3.13%) is due in December 2020, confirming our opinion that debt-repayment costs should remain insignificant over the near term. The firm has no defined-benefit pension scheme, so it will not be required to make cash payments to employees' pensions. We like the flexibility that Polaris' dividend provides, as it could be cut in the event of a liquidity crisis. We don't expect this will be the case, as the interest earned ratio, which was 11 times in 2007, had grown to more than 60 times in 2014.

The company maintains flexibility in its capital structure

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through stock repurchases and dividends. Polaris had up to 1.1 million shares of stock available for repurchase at 2014 year-end; however, we expect management to take a prudent and conservative approach to repurchases again in 2015. With the stock price down materially over the past year, we think management could buy back shares strategically over the rest of the year. The dividend also allows the firm to manage the cash it keeps on the balance sheet, at $0.53 per quarter, and we would expect Polaris to be hard-pressed for cash before it reduced or canceled this return of cash to shareholders.

Enterprise Risk

Polaris faces a number of different risks regarding the demand for its products. Motorcycles, snowmobiles, and ATVs are all big-ticket items, and a slowdown in the global economic environment could hamper the replacement and adoption rates of these recreational products. Another domestic downturn could also affect financing rates at the dealer (floor plan) and retail levels. In 2014, consumers financed about one third of the vehicles sold through Capital One, Sheffield, Synchrony, or Freedom Road, and changes in lending standards could prove problematic. The company also faces integration risk, particularly as it has become more acquisitive (Timbersled, Brammo, and Pro Armor were recent acquisitions), and liability risk, as it self-insures against product liability claims. Weather is the biggest factor Polaris cannot control; sales of snowmobiles are correlated with the amount of snowfall generated in any given season, making volume in this segment more volatile than the others. Finally, foreign exchange exposure could prove unpredictable as the firm grows internationally. Additionally, global consumer confidence remains unstable, making sales uncertain.We remain concerned that the power sports industry already has a number of key players that can compete on price to take share from Polaris. In ATVs, competitors like Yamaha and Deere are formidable players, while Victory and Indian have to compete with motorcycle manufacturing giants Honda and Harley-Davidson. All of the aforementioned brands have huge franchises and financial resources, which could cause the competitive environment to become promotional. Although Polaris has held its ground against these incumbents, competitive winds got the best of the company in 2004 when it sold its personal watercraft business, and the concern remains that it could happen again.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
MR. SCOTT W. WINE	Director	249,831	13 Feb 2015	—
BENNETT J. MORGAN		109,955	13 Feb 2015	—
MICHAEL W. MALONE		86,631	13 Feb 2015	—
SURESH KRISHNA		58,734	02 Mar 2015	—
KENNETH J. PUCEL		50,000	28 Jan 2015	—
MS. STACY BOGART		30,715	24 Feb 2015	—
MATTHEW J. HOMAN		24,625	18 Aug 2015	—
DAVID C. LONGREN		21,855	18 Aug 2015	—
JAMES P. WILLIAMS		14,460	13 Feb 2015	—
STEPHEN L. EASTMAN		10,528	19 Feb 2015	—

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
Neuberger Berman Genesis Fund	1.58	1.31	-361	30 Jun 2015
Vanguard Mid-Cap Index Fund	1.95	0.25	-1	30 Sep 2015
Fidelity® Capital Appreciation Fund	1.56	1.64	9	31 Aug 2015
Vanguard Total Stock Mkt Idx	1.69	0.04	7	30 Sep 2015
iShares Core S&P Mid-Cap (AU)	1.50	0.45	1	30 Oct 2015
Concentrated Holders				
CGM Focus Fund	0.74	7.48	—	30 Jun 2015
Lemanik SICAV World Daytona	0.02	5.69	—	31 Jul 2015
Matthew 25 Fund	0.44	5.67	—	30 Jun 2015
CGM Mutual Fund	0.24	5.31	5	30 Jun 2015
Kesem KTF Morningstar Wide Moat	—	4.76	0	31 Jul 2015

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
Citadel Advisors Llc	2.99	0.26	1,639	30 Jun 2015
Janus Capital Management LLC	1.54	0.19	1,020	30 Jun 2015
Waddell & Reed Investment Management Co	2.05	0.29	735	30 Jun 2015
Blair William & Co	2.36	0.35	334	30 Jun 2015
Baird Robert W & Co, Inc.	0.45	0.44	301	30 Jun 2015
Top 5 Sellers				
Wells Capital Management Inc.	0.05	0.01	-1,353	30 Jun 2015
Fidelity Management and Research Company	3.97	0.05	-479	30 Jun 2015
Neuberger Berman LLC	2.97	0.32	-454	30 Jun 2015
Geneva Inv Mgmt Of Chicago LLC	0.10	0.17	-250	30 Jun 2015
Deutsche Bank AG	0.13	0.02	-212	30 Jun 2015

Management 23 Jul 2015

We view Polaris' stewardship of shareholder capital as Exemplary. CEO Scott Wine, appointed in August 2008, has international experience at a range of companies, including Honeywell and Fire Safety Americas, where he was president. Since taking the helm, Wine has delivered a tremendous record of execution, expanding the firm's gross margin at a time when shipments were declining and making smart acquisitions to expand the company's global presence and brand. His strategic initiatives, including the shifting of some production to newer facilities abroad, will probably deliver further cost savings. We think Polaris has a fairly deep management bench, and we have been impressed by the segment heads to execute well. The company incorporates long-term incentives for its executives that are based on cash, stock options, and restricted stock units, which we believe aligns management goals with long-term shareholder goals. Polaris directors must hold stock worth at least least 3 times the amount of the annual retainer and any committee chairman fee within four years of being elected to the board. Currently, directors and officers own only 3% of outstanding shares, but the top four shareholders (one of which is the ESOP plan) own 26% of shares, which could make change by individual shareholders difficult. Overall, we think the firm has an above-average level of independence in the board room (seven out of eight directors are independent), with Wine the only nonindependent director. We applaud the firm for its use of majority voting rules in shareholder meetings, but we would prefer to see all directors facing re-election every year rather than the current staggered elections in place because this may protect the board from being ousted in a takeover.

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115.34 USD	160.00 USD	96.00 USD	248.00 USD	High	Wide	Stable	Exemplary	Autos

Analyst Notes

Despite Competitive Industry Trends, Polaris Remains on Solid Footing; Shares Undervalued 21 Oct 2015

In light of foreign-exchange headwinds and competitive pricing across the powersports industry, Polaris delivered solid third-quarter results. However, the business continues to bump up against capacity constraints and work through its paint issues in the motorcycle segment, leaving a backlog in demand that is still to be worked through. We view the biggest concern to the company as the ongoing competitiveness in the sizable off-road vehicle segment (which comprised 62% of reclassified enterprise sales last year), as peers in the category aggressively discount and come to market faster with new products than in the past. We expect to take our $169 fair value estimate down modestly in response to competitive changes in the off-road category, rendering the growth rate slower than we have previously modeled. With shares trading around 13 times our 2016 estimate, we view shares as undervalued, but caution investors that there could be some uncertainty surrounding the name as industry inventory at retail is worked through, and while the firm continues to close the gap on its backlog.

Despite rising foreign-exchange headwinds, which have led to guidance for gross margins that contract 40-60 basis points for the full year (versus flat previously), Polaris has been able to maintain its fiscal 2015 earnings per share estimate, narrowing to the high end of its prior range at $7.37-$7.42 (we had $7.36 modeled), as it exercises diligent cost control across the business. Operating expenses are set to fall 50-60 basis point (20-30 basis points prior), indicating to us that management is pulling on all levers to drive value for its shareholders. The long-term strategy of the firm is intact, still focused on lean, global market leadership, 5%-8% organic growth, and net income margins above 10%. Our top-line growth assumes slightly better revenue as a result of acquisitions, and our bottom line is also modestly higher, above 11%, as we expect expenses to lever on volume.

During the quarter, total sales rose 12%, to $1.5 billion, and all categories delivered positive results, with off-road growing 3%, snowmobiles up 14%, global adjacent markets rising 10%, and motorcycles outperforming wildly, up 154% thanks to strong Slingshot and Indian performance (despite a still-significant backlog). All-terrain vehicles and side-by-sides were able to gain share (both growing at a low-single-digit pace) as the ATV industry declined slightly and the side-by-side industry delivered positive results that were slightly slower than Polaris'. Gross margins fell 130 basis points to 28.5%, with foreign exchange driving 60% of the decline, with the additional inflated costs attributable to incremental motorcycle manufacturing costs and higher promotional expenses. The company was able to offset some of this by diligently executing on costs, and the operating expense ratio fell 80 basis points year over year to 13.2%. Total dealer inventory was 14% higher than the third quarter of 2014, but off-road inventory, which had been problematic in recent periods, rose only 10% and is expected to fall to a mid-single-digit rate by the end of the year.

From our vantage point, the brand prowess that Polaris has cultivated and the operational excellence that has become a bloodline of the business still exist. We think shares have recently been unfairly punished for missteps in the evolving paint process at its motorcycle plant in Spirit Lake, Iowa, and the structurally changing landscape in the off-road segment. However, we believe the company is taking all the possible steps to rectify any concerns it can control. Polaris purchased a paint facility in Spearfish, South Dakota, earlier this week (the old Lehman Trike facility), which will add 10% paint capacity, and is upgrading processes to improve flow at Spirit Lake, which should increase paint capacity 30%, both in 2016. We don't expect all aspects of the business to run smoothly all the time, and view the paint missteps as a hiccup across otherwise very disciplined manufacturing

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Analyst Notes

processes at the company. With regards to off-road, we don't see changes to the competitive landscape as self-inflicted and think the company is still competing at the top of its class in the category. However, with other compelling products coming to market faster and peers like Arctic Cat and BRP attempting to close the gap, we do not believe challenges will abate and plan to reduce our long-term top-line growth rate for the segment by 1%-2% to account for the evolving environment.

All considered, Polaris still delivers some of the best returns on invested capital (50%) we've seen from a business across numerous sectors. With little leverage on the balance sheet and plenty of cash on hand, the firm can remain nimble, investing in innovation and acquiring adjacent businesses to grow the top line ahead. We believe peers will continue to try to close the gap, making Polaris work a little harder than it has had to in the past, but we don't see market leadership or brand degradation occurring any time soon if the company continues to deliver products that cater to consumer demands and offer entry into new categories.

Polaris Slows Product Launch Cadence as Competition Persists and it Restores Operational Excellence 29 Jul 2015

With a long history of successful product launches, we would normally be disappointed that the pace of product innovation at wide-moat Polaris' dealer event was much lower than in prior years. We aren't completely surprised that fewer products were introduced this year than usual, since the company has recently had problems delivering supply to match the demand, and aggressive new product launches for model year 2016 would have exacerbated this bottleneck further. There were some ORV products offering more power and torque than previous models, which is where we believe Polaris will be able to take positive pricing action in its biggest segment. However, the competitive environment is likely to persist through year-end, as some peers continue to take pricing actions to correct inventory in the retail channel and capitalize on the exchange rate differential, making market share gains difficult in the near term.

Unfortunately, off-road vehicles, which comprised 65% of sales last year, will likely experience the broadest slowdown in growth (snowmobiles have been part of a slow-growing industry for years now) over the near term, as competitors have brought innovative offerings to the market to compete more fiercely with Polaris at compelling price points. However, the company's long-term goals of $8 billion in sales and net income margins of over 10% were reiterated, driven by the relentless innovation and operational excellence through the end of the decade. This, in turn, has left our $169 intrinsic value intact.

We view shares as undervalued, trading at a 21% discount to our fair value estimate. We suspect shares have recently been punished, falling nearly 10% year to date as the company corrects its first operational hiccup in many years, with the implementation of a new paint system at Spirit Lake falling short of expectations. However, on-road products are produced at Spirit Lake, and represented only 8% of sales, in 2014--which means most of the business was not affected by this hiccup. Additionally, the backlog that has been created by the flawed paint implementation is expected to be resolved by year-end as the company has restored the original paint system.

We think the management team has been extremely forthright in acknowledging its missteps and addressing resolutions to restore order flow. Over the last year-plus, Polaris has struggled to meet demand not only in the motorcycle segment, but in off-road vehicles, as the business has bumped up against capacity constraints. It seemed the company slowed the cadence of its new product introductions at this year's dealer days in order to repair the

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Analyst Notes

backlog and better meet demand at first glimpse.

However, we believe there was something very strategic and tactical surrounding product launch decisions this year that could position the company to improve market share longer term for two reasons. First, launching a litany of new products in a very competitive pricing environment could make it difficult to take full pricing actions on new model year products. Introducing products at a slower cadence than in the past prevents the entry of compelling new products at a time when peers can cut prices significantly to steal share--and allows them to come on line when the level of discounting recedes, garnering full pricing power and market share grab potential for Polaris. Second, the company noted that product launches will start to occur throughout the year going forward, helping avoid a bump in demand as the model year changes every summer from leading to a bottleneck in the manufacturing process. Both of these reasons stand to improve operating efficiency and brand equity, supporting our wide moat thesis.

By segment, global adjacent markets and motorcycles are set to be the growth drivers for the business over the next five years. The five-year plan for global adjacent markets (which was recategorized last year from small vehicles) includes achieving revenues of $2 billion, from about our forecast of about $287 million in 2015 (6% of total estimated revenues), implying an annual growth rate of approximately 50% in the segment. If Polaris could reach this goal it would add around $25 to our current $169 fair value estimate. However, for this new fair value to be achieved, the operating margin profile of any acquired businesses would have to be in line with current company averages (which is unlikely), expansion into younger markets would have to be cost-effective (but is likely to be lumpy) and there have to be enough acquisition opportunities at the right price with the right fit to lend to about half of that segment's upside potential in our opinion, since doubling the current global adjacent market business over the next five years would only offer just under $600 million in revenues. This last hurdle, finding significant acquisition opportunities, could be the most difficult to clear, and we are holding off on modeling any major material acquisitions until we hear otherwise. Because of these three factors combined, we'd expect a much more modest increase in our fair value estimate if the segment executed perfectly. For now, the global adjacent market segment grows between 20% and 30% in our model, and includes small acquisitions and organic product introductions, which is still impressive.

On-road continues to make strides as well, closing on a successful first year of Slingshot shipments, with more than 5,000 anticipated to flow to dealers in 2015, by our estimate. The breadth of target market reach that the Victory, Indian, and Slingshot brands reach are promising and brand awareness (particularly for Slingshot) remains low, at just 9%. Our forecast has the segment growing threefold by 2020, from $349 million in 2014 to $1.1 billion in 2020. When Slingshot was launched in 2014, it was estimated to grow to $300 million to $500 million over three to five years, and it is expected to represent more than $100 million in fiscal 2015, so our confidence in the path to a more than $1 billion business over the next five years is higher now than in the past.

Any upside in operating performance will likely come from the diligent processes Ken Pucel (EVP of Global Operations, Engineering and LEAN) is planning to implement. With a five-pronged Lean strategy set to take hold (improving customer facing metrics, flow, plant operations, product development and processes), Pucel believes the company can improve gross margins by 300-500 basis points (from 29.4% in 2014, just 30 basis points under its peak over the last decade). While the enterprise doesn't expect this to flow through as it incurs higher expenses to grow the business, we think investors could be surprised by some

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Analyst Notes

incremental benefit here as continuous improvement moves through different business segments, and we have had our long term net income margins just under 12% for some time now (which we have Polaris reaching in 2021).

Near-Term Competition Should Persist for Polaris Products, but Our Long-Term Thesis Is Intact 22 Jul 2015

Although 2015 seems to be bumpier than usual for Polaris, we think the outlook remains healthy for the company, which is still expected to grow top- and bottom-line results at a low-double-digit rate for the full year despite foreign exchange headwinds and elevated price competition from its peers. The diversification of this wide-moat manufacturer offers stability and sustainability in profit growth over time, healthy and weak segments and geographies are able to offset each other as each independent economic cycle progresses. As long as innovation does not wane, we expect Polaris should be able to continue to grab market share in its traditional segments (ATVs, snowmobiles) from foreign manufacturers, and that product line expansions (like the Slingshot and Multix) will boost sales to new, previously untapped consumers. We view shares as undervalued, trading at a 14% discount to our $169 fair value estimate and 17 times 2016 earnings.

We expect to hear more about the company's long-term strategic plan and meet the company's new chief financial officer at its investor day next week, when we will adjust our outlook accordingly. Polaris' Exemplary stewardship ranking will remain intact as long-term CFO Mike Malone departs and new CFO Mike Speetzen takes over, bringing financial and operating expertise from Xylem and before that Allied Signal. The five-year strategic objectives, which will likely be updated next week, were reiterated, seeking $8 billion in revenue and more than 10% in net income margins (which the enterprise already generates) by 2020. Although we were surprised to hear management articulate that it could possibly squeeze 200-300 basis points out of cost of goods sold over time, it was noted that operating margin expansion would ultimately be limited by weaker operating performance of bolt-on acquisitions (which has been noted in the past).

The second quarter provided a picture of a very competitive environment, but proved successful for the enterprise in certain categories. Off Road Vehicle sales grew 2%, at the slowest pace since the fourth quarter of 2009, as the company reduced shipments to improve dealer inventory levels, which have been bloated across players in the industry. Similarly, Global Adjacent Market growth was slow, falling 3%, as foreign exchange disproportionately weighed on the segment and Goupil performance waned. Motorcycle revenue, however, grew wildly, rising 57% as Indian and Slingshot brands offset weak Victory sales. This upside was bound by throughput constraints, which has created a fairly significant backlog for the company—we expect this to persist through the end of the year. Snowmobile sales also rose more than 200% (in a seasonally small quarter) as dealers admired the new Axys RMK lineup for the year ahead. Gross margins suffered, down 166 basis points to 28.4% as foreign exchange (impact of $18 million) and competitive discounting headwinds persisted, along with self-inflicted costs from delays surrounding the completion of the Spirit Lake paint system, creating $9 million in additional expenses (and which has constrained motorcycle throughput). Inventory levels appear to be coming in line better with demand, and it seems that Off Road Vehicles may be the only remaining segment with slight overhang, which it should be rectifying over the remainder of 2015.

Overall, we didn't view the fiscal year outlook as disappointing, despite top line and earnings per share growth expectations of 10%-12% being markedly slower than the past few years. With the strengthening of the dollar, nearly all global companies reporting results have been materially impacted, and with Canada representing 10% of

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Analyst Notes

sales, and other markets outside the US representing another 15% of total sales, we see how significantly translated results could be skewed. The management team has been humbled by self inflicted problems, most notably the concerns regarding the paint system in Spirit Lake, and we didn't think that growth would come smoothly all the time—all businesses have implementation hiccups as they grow, some more noticeable than others. We still view the product line up as the driving factor in growth ahead, with the newest product coming out of its joint venture with Eicher, Multix (a multi-role personal vehicle—for family, power and business), as indicative of Polaris' ability to think outside the box to create a new product with unmet demand. The balance sheet remains strong, with little leverage, leaving us confident that Polaris remains positioned to perform well and make smart strategic acquisitions as it sees fit over time.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2012	2013	2014	*2015* (Forecast)	*2016* (Forecast)	*5-Year Proj. CAGR*
Revenue	*19.0*	20.8	17.7	18.6	*10.7*	*8.7*	*9.1*
EBIT	*26.8*	38.6	20.0	22.6	*10.0*	*7.7*	*9.6*
EBITDA	*26.4*	33.5	21.3	24.7	*16.9*	*5.2*	*10.2*
Net Income	*25.9*	37.2	22.0	19.2	*10.6*	*11.1*	*10.4*
Diluted EPS	*27.6*	37.3	22.7	23.3	*11.4*	*12.0*	*12.1*
Earnings Before Interest, after Tax	*24.3*	35.8	35.1	4.6	*24.5*	*10.3*	*12.9*
Free Cash Flow	*17.8*	57.8	-67.8	221.4	*62.8*	*14.3*	*20.6*

Profitability	3-Year Hist. Avg	2012	2013	2014	*2015*	*2016*	*5-Year Proj. Avg*
Operating Margin %	*15.5*	15.1	15.4	16.0	*15.8*	*15.7*	*16.0*
EBITDA Margin %	*18.0*	17.3	17.9	18.8	*19.8*	*19.2*	*19.6*
Net Margin %	*10.0*	9.7	10.1	10.1	*10.1*	*10.3*	*10.5*
Free Cash Flow Margin %	*5.7*	8.4	2.3	6.3	*9.2*	*9.7*	*9.9*
ROIC %	*65.3*	83.7	64.1	48.0	*50.5*	*52.1*	*56.4*
Adjusted ROIC %	*89.1*	113.4	89.4	64.5	*64.9*	*66.0*	*71.0*
Return on Assets %	*23.7*	23.0	24.0	24.2	*22.4*	*21.4*	*21.6*
Return on Equity %	*59.4*	52.5	61.7	64.0	*49.5*	*42.8*	*42.8*

Leverage	3-Year Hist. Avg	2012	2013	2014	*2015*	*2016*	*5-Year Proj. Avg*
Debt/Capital	*0.22*	0.13	0.34	0.19	*0.15*	*0.12*	*0.12*
Total Debt/EBITDA	*0.28*	0.18	0.42	0.24	*0.20*	*0.19*	*0.18*
EBITDA/Interest Expense	*92.49*	93.82	108.72	74.93	*86.73*	*137.41*	*145.07*

Valuation Summary and Forecasts

	2013	2014	*2015(E)*	*2016(E)*
Price/Fair Value	1.03	0.91	—	—
Price/Earnings	27.0	22.7	*15.6*	*13.9*
EV/EBITDA	13.7	12.0	*7.8*	*7.4*
EV/EBIT	15.9	14.1	*9.7*	*9.0*
Free Cash Flow Yield %	3.3	2.4	*6.0*	*7.4*
Dividend Yield %	1.2	1.3	*1.9*	*2.4*

Key Valuation Drivers

Cost of Equity %	9.0
Pre-Tax Cost of Debt %	5.3
Weighted Average Cost of Capital %	8.9
Long-Run Tax Rate %	33.8
Stage II EBI Growth Rate %	5.6
Stage II Investment Rate %	28.0
Perpetuity Year	20

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	USD Mil	Firm Value (%)	Per Share Value
Present Value Stage I	4,535	39.7	66.98
Present Value Stage II	2,836	24.8	41.89
Present Value Stage III	4,049	35.5	59.80
Total Firm Value	**11,421**	**100.0**	**168.67**
Cash and Equivalents	138	—	2.03
Debt	-203	—	-2.99
Preferred Stock	—	—	—
Other Adjustments	-367	—	-5.43
Equity Value	**10,988**	**—**	**162.28**
Projected Diluted Shares	68		
Fair Value per Share (USD)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

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Morningstar Analyst Forecasts

Income Statement (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	*Forecast* 2015	2016
Revenue	**3,210**	**3,777**	**4,480**	***4,961***	***5,394***
Cost of Goods Sold	2,284	2,656	3,160	*3,525*	*3,819*
Gross Profit	**925**	**1,121**	**1,319**	***1,436***	***1,575***
Selling, General & Administrative Expenses	353	450	518	*540*	*604*
Other Operating Expense (Income)	120	134	148	*179*	*199*
Other Operating Expense (Income)	-34	-46	-62	*-69*	*-74*
Depreciation & Amortization (if reported separately)	—	—	—	—	—
Operating Income (ex charges)	**486**	**583**	**715**	***786***	***846***
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	**486**	**583**	**715**	***786***	***846***
Interest Expense	6	6	11	*11*	*8*
Interest Income	0	-2	-4	*-5*	*0*
Pre-Tax Income	**480**	**574**	**699**	***769***	***839***
Income Tax Expense	168	193	245	*267*	*281*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	—	—	—	—	—
(Preferred Dividends)	—	—	—	—	—
Net Income	**312**	**381**	**454**	***502***	***558***
Weighted Average Diluted Shares Outstanding	71	71	68	*68*	*67*
Diluted Earnings Per Share	**4.40**	**5.40**	**6.65**	***7.41***	***8.30***
Adjusted Net Income	312	381	454	*502*	*558*
Diluted Earnings Per Share (Adjusted)	**4.40**	**5.40**	**6.65**	***7.41***	***8.30***
Dividends Per Common Share	1.43	1.61	1.86	*2.12*	*2.66*
EBITDA	**557**	**675**	**842**	***984***	***1,035***
Adjusted EBITDA	**557**	**675**	**842**	***984***	***1,035***

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Morningstar Analyst Forecasts

Balance Sheet (USD Mil)

Fiscal Year Ends in December

	2012	2013	2014	*Forecast 2015*	*Forecast 2016*
Cash and Equivalents	417	92	138	*359*	*613*
Investments	—	—	—	—	—
Accounts Receivable	120	186	205	*219*	*250*
Inventory	345	418	566	*573*	*635*
Deferred Tax Assets (Current)	86	93	114	*126*	*137*
Other Short Term Assets	50	76	74	*74*	*74*
Current Assets	**1,018**	**866**	**1,097**	***1,351***	***1,710***
Net Property Plant, and Equipment	253	455	555	*612*	*648*
Goodwill	107	230	224	*224*	*224*
Other Intangibles	16	31	69	*69*	*69*
Deferred Tax Assets (Long-Term)	22	19	41	*46*	*50*
Other Long-Term Operating Assets	70	85	89	*99*	*107*
Long-Term Non-Operating Assets	—	—	—	—	—
Total Assets	**1,486**	**1,685**	**2,075**	***2,400***	***2,808***
Accounts Payable	169	238	343	*320*	*368*
Short-Term Debt	3	3	3	—	—
Deferred Tax Liabilities (Current)	5	9	11	*13*	*14*
Other Short-Term Liabilities	454	497	493	*546*	*594*
Current Liabilities	**631**	**748**	**851**	***879***	***976***
Long-Term Debt	100	281	200	*200*	*200*
Deferred Tax Liabilities (Long-Term)	4	25	18	*20*	*22*
Other Long-Term Operating Liabilities	61	88	131	*145*	*158*
Long-Term Non-Operating Liabilities	—	—	—	—	—
Total Liabilities	**796**	**1,141**	**1,200**	***1,244***	***1,356***
Preferred Stock	—	—	—	—	—
Common Stock	1	1	1	*1*	*1*
Additional Paid-in Capital	269	361	486	*486*	*486*
Retained Earnings (Deficit)	409	156	402	*760*	*1,140*
(Treasury Stock)	—	—	—	*-78*	*-160*
Other Equity	12	27	-14	*-14*	*-14*
Shareholder's Equity	**691**	**544**	**875**	***1,156***	***1,452***
Minority Interest	—	—	—	—	—
Total Equity	**691**	**544**	**875**	***1,156***	***1,452***

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Morningstar Analyst Forecasts

Cash Flow (USD Mil)

Fiscal Year Ends in December	2012	2013	2014	*Forecast* *2015*	*2016*
Net Income	312	374	454	*502*	*558*
Depreciation	71	92	128	*198*	*189*
Amortization	—	—	—	—	—
Stock-Based Compensation	6	29	26	*27*	*31*
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	-29	-6	-50	*-14*	*-12*
Other Non-Cash Adjustments	-4	2	-13	—	—
(Increase) Decrease in Accounts Receivable	2	-54	-24	*-14*	*-31*
(Increase) Decrease in Inventory	-36	-52	-158	*-7*	*-62*
Change in Other Short-Term Assets	—	—	—	—	—
Increase (Decrease) in Accounts Payable	21	52	106	*-24*	*48*
Change in Other Short-Term Liabilities	73	55	61	*53*	*48*
Cash From Operations	**416**	**492**	**529**	***723***	***767***
(Capital Expenditures)	-103	-251	-205	*-255*	*-225*
Net (Acquisitions), Asset Sales, and Disposals	-41	-137	-28	—	—
Net Sales (Purchases) of Investments	-19	-18	-14	—	—
Other Investing Cash Flows	—	—	—	*5*	*4*
Cash From Investing	**-163**	**-407**	**-247**	***-250***	***-221***
Common Stock Issuance (or Repurchase)	-128	-530	-82	*-78*	*-83*
Common Stock (Dividends)	-102	-114	-127	*-144*	*-179*
Short-Term Debt Issuance (or Retirement)	-5	179	-82	*-3*	—
Long-Term Debt Issuance (or Retirement)	—	—	—	—	—
Other Financing Cash Flows	72	56	68	*-27*	*-31*
Cash From Financing	**-163**	**-409**	**-223**	***-251***	***-292***
Exchange Rates, Discontinued Ops, etc. (net)	1	-1	-15	—	—
Net Change in Cash	**92**	**-325**	**45**	***221***	***255***

Polaris Industries Inc PII (NYSE) | ★★★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Industry Group
115.34 USD	160.00 USD	96.00 USD	248.00 USD	High	Wide	Stable	Exemplary	Autos

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			EV/EBITDA			Price/Free Cash Flow			Price/Book			Price/Sales		
Company/Ticker	Price/Fair Value	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	1.11	13.6	14.2	12.7	11.7	10.7	8.8	76.4	37.4	45.2	1.3	1.2	1.2	0.6	0.6	0.6
Harley-Davidson Inc HOG USA	0.83	17.0	13.3	12.3	11.8	11.1	10.4	15.3	11.6	13.9	4.8	4.2	3.8	2.5	1.9	1.8
Arctic Cat Inc ACAT USA	0.66	16.5	27.3	310.9	7.4	11.7	13.7	31.1	12.5	NM	3.3	2.6	1.7	0.8	0.7	0.4
Average		15.7	18.3	112.0	10.3	11.2	11.0	40.9	20.5	29.6	3.1	2.7	2.2	1.3	1.1	0.9
Polaris Industries Inc PII US	**0.72**	**22.7**	**15.6**	**13.9**	**12.0**	**7.8**	**7.4**	**41.6**	**16.7**	**13.4**	**11.5**	**6.5**	**5.2**	**2.2**	**1.5**	**1.4**

Returns Analysis

		ROIC %			Adjusted ROIC %			Return on Equity %			Return on Assets %			Dividend Yield %		
Company/Ticker	Last Historical Year Total Assets (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	— JPY	7.3	5.6	8.2	7.3	5.6	8.2	10.7	7.4	6.8	6.0	4.3	4.0	2.2	2.2	2.3
Harley-Davidson Inc HOG USA	9,528 USD	29.9	26.4	27.9	30.2	26.7	28.2	28.5	28.3	31.1	8.9	8.2	8.8	1.7	2.4	2.6
Arctic Cat Inc ACAT USA	— USD	44.9	9.5	1.4	45.5	9.7	1.5	21.9	9.5	0.5	12.2	5.3	0.3	0.9	1.4	2.3
Average		27.4	13.8	12.5	27.7	14.0	12.6	20.4	15.1	12.8	9.0	5.9	4.4	1.6	2.0	2.4
Polaris Industries Inc PII US	**2,075** USD	**48.0**	**50.5**	**52.1**	**64.5**	**64.9**	**66.0**	**64.0**	**49.5**	**42.8**	**24.2**	**22.4**	**21.4**	**1.3**	**1.9**	**2.4**

Growth Analysis

		Revenue Growth %			EBIT Growth %			EPS Growth %			Free Cash Flow Growth %			Dividend/Share Growth %		
Company/Ticker	Last Historical Year Revenue (Mil)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)	2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	11,144,266 JPY	19.5	5.6	10.6	55.1	5.4	24.1	56.7	-11.4	13.3	NM	-8.7	28.1	9.7	11.4	7.0
Harley-Davidson Inc HOG USA	5,568 USD	5.9	-4.4	4.7	11.2	-8.4	7.1	18.3	-3.0	7.7	13.9	-5.7	-11.5	31.3	12.7	7.7
Arctic Cat Inc ACAT USA	730 USD	8.8	-4.3	-5.3	-0.4	-68.5	-82.6	0.3	-54.0	-94.9	21.1	110.5	-138.1	—	27.0	—
Average		11.4	-1.0	3.3	22.0	-23.8	-17.1	25.1	-22.8	-24.6	17.5	32.0	-40.5	20.5	17.0	7.4
Polaris Industries Inc PII US	**4,480** USD	**18.6**	**10.7**	**8.7**	**22.6**	**10.0**	**7.7**	**23.3**	**11.4**	**12.0**	**221.4**	**62.8**	**14.3**	**15.5**	**14.0**	**25.3**

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Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

Company/Ticker	Last Historical Year Net Income (Mil)	Gross Margin % 2014	2015(E)	2016(E)	EBITDA Margin % 2014	2015(E)	2016(E)	Operating Margin % 2014	2015(E)	2016(E)	Net Margin % 2014	2015(E)	2016(E)	Free Cash Flow Margin % 2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	574,670 JPY	4.8	*4.0*	*4.4*	8.8	*10.1*	*10.9*	4.8	*4.8*	*5.4*	5.2	*4.3*	*4.4*	0.8	*1.6*	*1.2*
Harley-Davidson Inc HOG USA	844 USD	36.4	*36.5*	*36.8*	28.1	*25.6*	*26.2*	23.0	*22.0*	*22.6*	15.2	*14.3*	*14.3*	16.4	*16.6*	*13.3*
Arctic Cat Inc ACAT USA	39 USD	20.7	*17.6*	*16.3*	10.2	*5.0*	*3.2*	8.3	*2.7*	*0.5*	5.4	*2.5*	*0.1*	2.7	*5.4*	*-2.4*
Average		20.6	*19.4*	*19.2*	15.7	*13.6*	*13.4*	12.0	*9.8*	*9.5*	8.6	*7.0*	*6.3*	6.6	*7.9*	*4.0*
Polaris Industries Inc PII US	**454** USD	**29.5**	***28.9***	***29.2***	**18.8**	***19.8***	***19.2***	**16.0**	***15.8***	***15.7***	**10.1**	***10.1***	***10.3***	**7.2**	***9.4***	***10.1***

Leverage Analysis

Company/Ticker	Last Historical Year Total Debt (Mil)	Debt/Equity % 2014	2015(E)	2016(E)	Debt/Total Cap % 2014	2015(E)	2016(E)	EBITDA/Interest Exp. 2014	2015(E)	2016(E)	Total Debt/EBITDA 2014	2015(E)	2016(E)	Assets/Equity 2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	565,319 JPY	11.3	*10.0*	*9.6*	10.1	*9.1*	*8.8*	122.0	*159.2*	*159.4*	0.6	*0.5*	*0.4*	1.7	*1.7*	*1.7*
Harley-Davidson Inc HOG USA	5,505 USD	189.2	*222.9*	*196.4*	65.4	*69.0*	*66.3*	-1,042.1	*310.0*	*52.7*	3.5	*4.0*	*3.6*	3.3	*3.7*	*3.4*
Arctic Cat Inc ACAT USA	— USD	—	—	—	—	—	—	612.2	*97.9*	*32.4*	—	—	—	1.8	*1.8*	*1.8*
Average		100.3	*116.5*	*103.0*	37.8	*39.1*	*37.6*	-102.6	*189.0*	*81.5*	2.1	*2.3*	*2.0*	2.3	*2.4*	*2.3*
Polaris Industries Inc PII US	**203** USD	**23.2**	***17.3***	***13.8***	**18.8**	***14.8***	***12.1***	**74.9**	***86.7***	***137.4***	**0.2**	***0.2***	***0.2***	**2.4**	***2.1***	***1.9***

Liquidity Analysis

Company/Ticker	Market Cap (Mil)	Cash per Share 2014	2015(E)	2016(E)	Current Ratio 2014	2015(E)	2016(E)	Quick Ratio 2014	2015(E)	2016(E)	Cash/Short-Term Debt 2014	2015(E)	2016(E)	Payout Ratio % 2014	2015(E)	2016(E)
Honda Motor Co Ltd HMC USA	59,926 USD	637.30	*764.88*	*750.43*	1.81	*1.63*	*1.63*	1.25	*1.09*	*1.07*	3.06	*3.11*	*3.05*	28.9	*39.1*	*41.6*
Harley-Davidson Inc HOG USA	10,276 USD	4.16	*2.66*	*1.97*	1.65	*2.06*	*2.37*	1.46	*1.81*	*2.07*	0.52	*0.53*	*0.52*	28.4	*33.0*	*33.0*
Arctic Cat Inc ACAT USA	286 USD	1.66	*3.08*	*0.83*	1.92	*1.99*	*1.72*	0.97	*0.76*	*0.52*	—	—	—	13.5	*37.3*	*731.3*
Average		214.37	*256.87*	*251.08*	1.79	*1.89*	*1.91*	1.23	*1.22*	*1.22*	1.79	*1.82*	*1.79*	23.6	*36.5*	*268.6*
Polaris Industries Inc PII US	**7,562** USD	**2.02**	***5.30***	***9.13***	**1.29**	***1.54***	***1.75***	**0.62**	***0.89***	***1.10***	**54.43**	**—**	**—**	**28.0**	***28.6***	***32.0***

Research Methodology for Valuing Companies

Components of Our Methodology

- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

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The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values, whereas 1-star stocks trade at premiums to their intrinsic worth. Four key components drive the Morningstar rating: our assessment of the firm's economic moat, our estimate of the stock's fair value, our uncertainty around that fair value estimate and the current market price. This process ultimately culminates in our single-point star rating. Underlying this rating is a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's equity analysts.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our actual calculation of our fair value estimates. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns on invested capital over at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. The assumptions that we make about a firm's economic moat play a vital role in determining the length of "economic outperformance" that we assume in the terminal sections of our valuation model. To assess the sustainability of excess profits, analysts perform ongoing assessments of what we call the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from one year (for companies with no economic moat) to 10-15 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard perpetuity formula. In deciding on the rate at which to discount future cash flows, we use a building block approach,

Morningstar Research Methodology for Valuing Companies

Source: Morningstar, Inc.

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

*Please contact a sales representative for more information.

which takes into account expectations for market real return, inflation, country risk premia, corporate credit spread, and any additional systematic risk.

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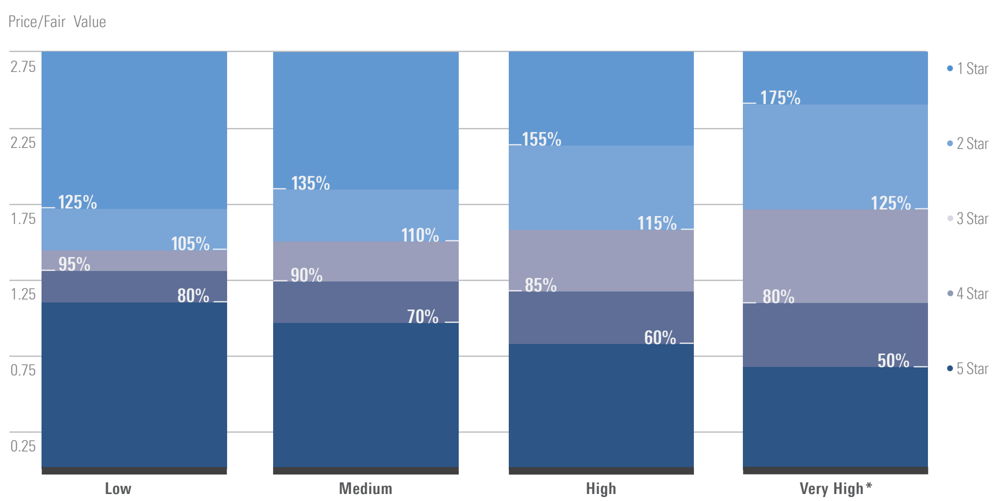
The Morningstar Uncertainty Rating captures the range of likely potential fair values and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the Fair Value Estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions. M

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Source: Morningstar, Inc.

Polaris Industries Inc PII (NYSE) | ★★★★

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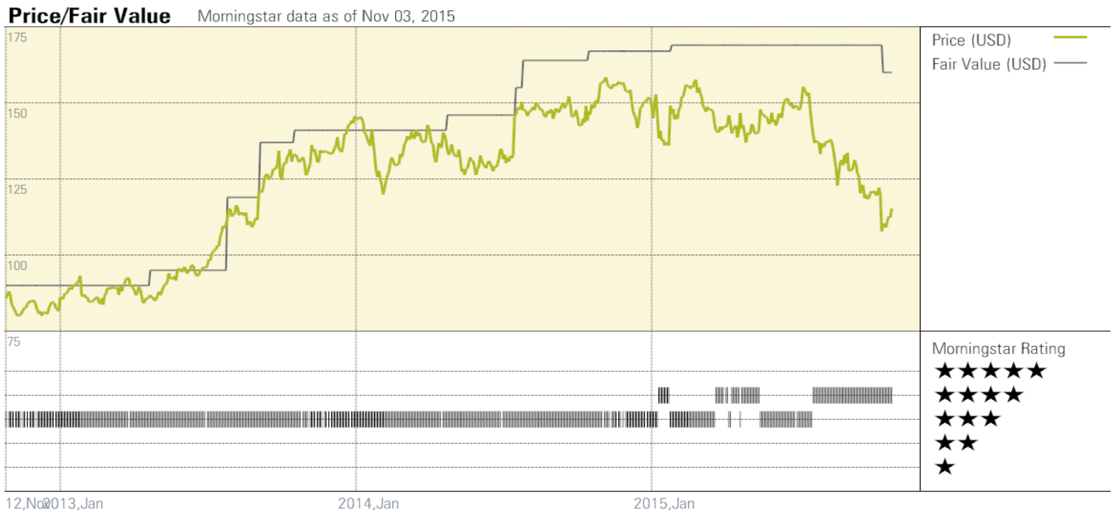

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