

Harman International (HAR)

-Long Investment

McIntire Investment Institute

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What Harman does....

- Harman is a manufacturer of high-fidelity audio equipment
- The business is divided into two main segments:
 - Consumer Group
 - Professional Group



Business Segmentation

■ Consumer Group

Manufactures loudspeakers, audio electronics, and Infotainment systems for home, car, and PC

77% of total sales

-58% OEM (up from 50% in 2001)

-19% Consumer

■ Professional Group

Manufactures loudspeakers and audio electronics for concert halls, stadiums, airports and other buildings

23% of total sales

down from 26% in 2001



Industry Analysis

- Harman Competes in a competitive and extremely fragmented market. The breadth of audio electronic systems they provide puts them in direct competition to many other companies.
- This means that Harman must take a new approach to remain a top player.....

Harman is taking a new approach... Infotainment

- 2001 was a transition year for Harman into the Infotainment market.
- June 30th 2002 Harman Introduced the First Infotainment system in the BMW 7-Series
- Infotainment/Telematics is a new system designed to fully integrate all of the interior control elements of a vehicle into one device
- Industry experts predict over 50% of cars will use this integrated system for all of their electronic content by 2010.

Infotainment

- Infotainment content can reach over \$2000 in high end automobiles....



Investment Thesis #1

- Harman will see increased sales to automotive OEM through established relationships and new ones
 - since Infotainment's debut in 2002, Harman has already sealed a number of contracts. VAR shows new contracts will continue
 - customer survey distributed found that many people who have experienced Harman audio in their cars will never go back to low quality sound.
 - as a provider of much more than just car audio, OEM's will want return to Harman for other devices.. Such as Infotainment
- Harman will see increased sales as a result of the "trickling down" effect
 - dealers see the consumer response to the system first hand. They expect to see the demand increase and the technology trickle down.

Investment Thesis #2

- Harman is a leader in an extremely fragmented industry. The only player who currently offers a fully integrated infotainment system.
- Most of Harman's top OEM competitors- Delphi and Visteon- do not have the breadth of products Harman offers, or the financial health. Bose could never enter this market
- Only Delphi has shown an interest in the Infotainment market

Investment Thesis #2 cont'd

- As the only player in the huge Infotainment market, can they keep the edge when competitors enter?... YES!!
- Research showed the complex nature of the system and the amount of coding that goes into integrating it with all of the functions of the car.
 - BMW Service Manager stated “We can’t even work on these systems anymore, they are too complex, we can only replace the device”
- Relationship is strong on both sides. Harman engineers found at OEM, OEM engineers found at Harman working together on these complex systems.

Investment Thesis #3

- **Harman has strong brands that:**

- Keeps consumers loyal. Survey showed people who owned Harman would buy again.

- Drives OEM demand. OEM's want ways to appeal to consumers, strong entertainment brands are a great way to do this.

- Lowers threat of competitors entering market. If Delphi were to enter Infotainment market, what strong brand do they have to match with the fully integrated system? None at the time

- Provides leverage in OEM negotiations. Risk of supplier squeeze is unlikely given Harman's brand strength. Pricing Power.

Where is MII's edge?

- Expectations about the future drive the present stock price:

-Although the stock has seen 35%+ move in recent months, I believe there is more upside to the price due to the misperceptions in the auto industry as a whole. These misperceptions are holding back the true valuation of Harman. My investment points and research show that Harman will see increased demand despite economics of the automobile industry.

-The Street.com released an article about an month ago announcing the stock as a short. I did not agree with the authors views.

-Short interest jumped to 13%, stock dropped to around \$58, now it's back up to \$67.

Risk #1

- 58% of total sales are tied to the OEM automotive market, up from 50% in 2001. Lehman Brothers estimates for every change in one million domestic automobile sales, Harman's exposure is \$.05-\$.07 per share.
- My estimate of the foreign OEM sales (high end market) based on the average amount of content per vehicle: \$.10-\$.15 per share

Risk #2

- Competitors entering Infotainment market possibly with partnerships or acquisitions of strong audio brands
- If a competitor did enter the Infotainment market tied to a strong brand, it would take away from new contracts and even erode current contracts.

Risk #3

- Low demand

- As a luxury item, Infotainment may not catch on quickly.

- Non OEM sales to Consumer and Professional Group could continue to decrease

Key financial figures

Stock Price \$67

Beta .98

Market Cap 2.14B

P/E 29

ROA 5.58

ROE 15.48

Interest Coverage 5.86

Short Interest 9.6%



Questions?