

BARRON'S

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Demand Triggers Upside in Firearms

Merriman Curhan says trends have spiked in the last five years.

Merriman Curhan Ford

ACCORDING TO DATA FROM both the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) and the National Shooting Sports Foundation (NSSF), annual domestic commercial firearms-industry sales are estimated at more than \$4.1 billion, which includes \$1.21 billion for handguns, \$1.35 billion for long guns and \$1.55 billion for ammunition.

In addition, annual sales of firearms and ammunition to the U.S. military and law-enforcement markets are estimated at \$1.7 billion and \$475 million, respectively.

Over the past 27 years, wholesale shipments for handguns, long guns and ammunition have increased at a combined compounded annualized growth rate (CAGR) of 5.5%. However, the CAGR has almost tripled to 15.1% during the past five years due to, we believe, increased concerns about personal safety, potential adverse changes in legislation and an increase in overall interest, especially among women and first-time buyers.

We conducted surveys with more than 100 firearms retailers nationwide (chains and independents) and not only found that firearms demand and sentiment remains solidly positive for both handguns and long guns (even against last year's tough comparisons), but that first-time buyers have been increasing, last year's first-time buyers are coming back for additional firearms, and women are representing an increasing percentage of buyers.

Even though there are approximately 50 companies manufacturing handguns and 125 manufacturing long guns, approximately 95% and 92%, respectively, of the handguns and long guns produced in 2008 were from the top 20 manufacturers. Given the importance of entering niche segments with loyal brand enthusiasts, we believe consolidation will remain a major theme in the firearms industry as it has increasingly become over the five years.

Handguns have numerous positive drivers. With an already heightened demand for personal protection firearms (e.g., concealed carry), we believe the recent Supreme Court ruling in favor of the Second Amendment should lead to increased demand for handguns as well as a potential reversal of currently restrictive legislation at the state and local levels.

Even though the number of hunting license holders has declined steadily over the past 20 years, we believe the stabilizing trends over the past five years along with an improved economic outlook, an increased participation by women and younger consumers, as well as more diversified hunting patterns should lead to a rebound in hunting firearms demand in the coming years.

Here are the handgun contributions for the two pure-play publicly traded firearms companies:

- **Smith & Wesson** (ticker: SWHC) (rated at Buy): For fiscal 2010 (ended April 2010), handguns generated \$204.5 million in revenue, which accounted for 60% of total firearms revenue and 50% of the company's total overall revenue (including contributions from non-firearms and the perimeter security division).
- **Sturm Ruger** (RGR) (not rated): For fiscal 2009 (ended December 2009), handguns generated \$145.8 million in revenue, which accounted for 55% of total firearms revenue and 54% of the company's total overall revenue (including contributions from non-firearms and casting sales).

Here are the long gun contributions for the two pure-play publicly traded firearms companies:

- **Smith & Wesson:** For fiscal 2010, long guns generated \$96.4 million in revenue, which accounted for 28% of total firearms revenue and 24% of the company's total overall revenue (including contributions from non-firearms and the perimeter security division).
- **Sturm Ruger:** For fiscal 2009, long guns generated \$103.4 million in revenue, which accounted for 39% of total firearms revenue and 38% of the company's total overall revenue (including contributions from non-firearms and casting sales).

There are two main publicly-traded companies that have operating divisions catering to the ammunition segment -- for which ammunition represents a sizable share of their overall results:

- **Olin** (OLN) (not rated): The Winchester division of Olin manufactures small caliber ammunition for the consumer, law-enforcement and military markets. During calendar 2009, the Winchester division generated \$568 million in revenue (37% of total revenue and 16% growth over calendar 2008 revenue) with \$69 million in operating revenue (12% margin).
- **Alliant Techsystems** (ATK) (not rated). The Commercial Products segment of Alliant Techsystems' Armament Systems division manufactures ammunition for the sport hunting and enthusiast markets under the brands Federal Premium, Fusion and Estate Cartridge. The company also produces ammunition for the law-enforcement market under the brands CCI and Speer brands. The Armament Systems division in total (which includes numerous other segments) generated total fiscal 2010 revenue of \$2.16 billion (45% of total revenue).

-- Eric Wold -- Greg Scott