
AMMO, Inc. (POWW): A Little Firepower to Your Portfolio

Operators,

Mr. Bean here.

Starting at the A's in my list of OTC stocks I stumbled upon Ammo, Inc. (POWW). The company produces high performance, precision ammunition for rifles and handguns. The stock is tiny (\$100M market cap) and **very** illiquid (trading volume averages less than 5,000 shares daily). So what got me excited enough to profile the company on the blog? There are three main drivers of future growth which (if executed well) can add substantial value to the company over the next five years. The company also sports a rock-solid balance sheet, providing ample downside protection should one (or more) drivers fail. Finally, management owns over 25% of the company; interests are aligned.

What's To Like?

Large Addressable Market

The company is situated in an industry ripe for disruption (many ammunition producers crank out the same product year after year — lack innovation) with attractive, growing demographics and large TAM. POWW estimates the TAM for both Consumer & Military / Defense to be around \$32B globally with \$8B in US.

This market is driven by increasingly positive demographic trends in the United States. Target Shooting participation is up 19% with 40.8M Americans participating annually. 15.7M people applied for Conceal/Carry permits in 2017, a 34% increase from 2014 figures. The average consumer is younger than five years ago (33 vs. 43), more women are participating (37% vs. 22%) and urban/suburban individuals increased participation over 12%.

Immediately Accretive Acquisition: Cash Generating & Vertical Integrations

AMMO recently acquired *Jagemann Stamping's* Brass Casing & Projectile Manufacturing business segment. The company paid \$17.4M cash and 4.75M in AMMO stock for the division. So what did AMMO receive for nearly \$24M total investment? For starters, Jagemann provides

the company with vertical integration capabilities. These vertical initiatives assure the company of consistent supply of key elements for manufacturing regardless of the business cycle. These supply chain savings result in lower COGS, leading to higher gross margins and increased profitability.

Along with these cost savings and integrations, AMMO receives a cash generating business expected to make an immediate positive impact to operating earnings. The company estimates the division will generate roughly \$25M in revenues and \$4M in operating earnings in 2019. In other words, AMMO paid roughly 6x operating earnings for a business that could generate a 16.67% ROI.

Products: One of A Kind, They Work and They're Protected

AMMO's most popular product is *Streak Visual Ammunition*. The company uses its exclusive patented technology to produce bullets that allow the shooter to see the bullet's path towards the target. If you're visualizing a Star Wars blaster, you're on the right track. These bullets are non-incendiary and don't generate heat, making them safe to use in environments where traditional tracers are banned. In a case like this, words don't do the product justice. [Here's a demo](#) of the bullets in action. The rounds are available in the following formats: Hollow points range from 380 Auto to 45 Colt, Total Metal ranges from 380 Auto to 44 Mag.

What makes this product exciting is its patented technology. AMMO, through SW Kenetics (merger of all IP and patent technology), is the only manufacturer allowed to use the non-incendiary tracer technology. This creates tremendous competitive advantages with high barriers to entry. If a competitor wants to replicate AMMO's *Streak Visual* product, they're left with really only one option (two less so):

1. Buy-out AMMO, Inc. and roll their manufacturing into other divisions (appears to be the most logical route).
2. Pay a ludicrous amount for the IP rights (which AMMO, Inc. would be *stupid* to sell).
3. Negotiate a deal with AMMO, Inc. whereby AMMO receives a royalty for another company using their patents (don't see this happening either).

Technologically superior products garner higher margins. Shifting their price point and quality towards a "premium" brand, the company projects product margins to reach 35%, significantly higher than the 10 – 20% averages across the industry.

The company produces other types of ammunition such as the Jesse James & Jeff Rann series, but this is for commercial use, and I don't believe the long-term driver of value comes from these products. I look at sales from these divisions as sources of cash to plow into their Streak Visual tech.

Where Will Growth Come From?

Consumer Channel: Bass Pro Shops Main Driver

The company sells to consumers via three channels: Two-Step Distributors (*Sports South, AcuSport, Zanders, etc.*), Mass Merchants / Online (*Cabela's, USA Midway, Bass Pro Shops, etc.*) and Buying Groups (*Sports Inc., the Nation's Best Sports*). Bass Pro Shops has shown to be an early treasure trove for AMMO's Streak Visual Ammunition sales.

Bass Pro recently rolled out *Visual Streak* across 142 stores and featured the ammo in its *2nd Amendment Savings* flyer. Two weeks after the release AMMO reported 250% increase in sales — not bad! Continued sales growth should garner more prime in-store real estate, creating a virtuous cycle of higher sales and greater customer capture.

Law Enforcement: Recent State Police Contract

Law Enforcement contracts provide high visibility into revenues with many of these contracts spanning several years. AMMO's products fill every law enforcement need from target rounds to tactical, defense applications. The company recently signed a contract with an Arizona Law Enforcement division which covers one of the state's largest counties. Revenues from this contract will begin in 2Q 2019. AMMO is *just now* entering the Law Enforcement market. The runway for growth within this segment is very large.

Military / Government: The Real Breadwinner

It's no surprise that military contracts would provide the greatest growth for AMMO. Military contracts provide predictable highly visible revenue streams for manufacturers while creating barriers to entry for new products entering the space. AMMO created a division within the company to address specific military needs: Global Tactical Defense Division. The company's pitching two of their products for military use: *TAC-P Precision Ammunition* and *Visual Streak*.

Both products impressed at the 2019 *SHOT Show* in Las Vegas, NV. Ammo's TAC-P, which is marketed as a lower-cost (and more effective) armor penetrating bullet, demonstrated full penetration of 1/2 inch thick armor from 1,000 yards. No other bullet was able to achieve full

penetration from that distance (read: competitive advantage). On the heels of the successful demo, the company received *multiple* “Test & Evaluation” orders. These orders will be delivered by the end of 2Q 2019. AMMO also signed new distributor deals, expanding its market outside the US for the first time.

Capacity Capabilities & Other Risks

The company’s using 20% of their current max capacity of 100M rounds per year, with the ability to scale to 200M+ rounds per year. Beyond 200M rounds, the company will need to provide additional investment to keep up with growth. This leaves plenty of time for AMMO to reach profitability and scale without spending any money on PPE investment.

There are certain risks inherent to ammunition sales. First, commercial consumers tend to stock-pile purchases — creating high personal inventory levels that take time to run through. As one could guess, high personal inventories leads to lumpy sales cycles. This should be mitigated if AMMO is able to secure longer-term contracts with military and law enforcement, “smoothing” out these revenue trends.

Another risk is commodity prices adding upward pressure on input costs. Last year saw many ammunition companies raise prices on the heels of higher copper, brass and lead prices. This could be a threat to AMMO’s already higher priced products if consumers get tight with their wallets. We’ve seen what a rise in ammunition prices can have with Remington Outdoors recently filing for Chapter 11. However, the argument can also be made that those purchasing AMMO’s higher priced ammo aren’t worried about an incremental rise in prices.

Finally, I couldn’t do a write-up on an ammunition company without mentioning the political risk. Gun laws divide this country and ammunition takes collateral hits. In a recent example, 2016 Presidential candidate Hillary Clinton flirted with the idea of a 25% tax on ammunition purchases. That would certainly hurt the commercial side of AMMO’s business, but the military and law enforcement businesses wouldn’t be affected.

Valuation

The company expects to generate roughly \$50M in 2020 revenues, half coming from Jagemann’s completed acquisition and the other half from organic growth. When looking at the business, an EV/Sales of 2x seems fairly cheap for a rapidly growing, highly innovative ammunition company with multiple avenues for revenue and earnings expansion. AMMO’s balance sheet is rock solid. The company has \$6M in cash with \$3.5M in total current liabilities.

AMMO could be an acquisition target for a larger player (i.e., Strum Ruger, American Outdoor Brands, or Olin Corp.) as they eat away existing market share. Until then, there are multiple ways for the company to expand revenues, earnings, and cash flow. I feel comfortable knowing management has substantial skin in the game, even going so far as implementing a Stock Ownership Program for its Board Members (required to purchase a minimum stock amount equal to that of retainer). Investors could be handsomely rewarded if they're able to stomach the illiquidity that comes with investing in such OTC stocks.

EndNote:

Alex here.

Check out POWW's Executive Team.

EXECUTIVE TEAM

FRED WAGENHALS – CHAIRMAN, CEO & PRESIDENT

Founder of Action Performance Companies (formerly publicly held, now owned by International Speedway Corp. (Nasdaq: ISCA)) with sales of NASCAR-branded products of over \$400 million annually. Mr. Wagenhals specializes in the acquisition and monetization of licensed products, which we are now applying to the ammunition industry.

KATHY HANRAHAN – PRESIDENT, GLOBAL TACTICAL DEFENSE DIVISION

Ms. Hanrahan is a proven industry executive with 15 years of experience at TASER International (now operating as AXON Enterprise (Nasdaq: AAXN)) as its President, COO and CFO. Ms. Hanrahan also helped guide Lifelock through its pre-IPO development, acting as its Interim CFO.

MARK HANISH – PRESIDENT, GLOBAL COMMERCIAL SALES & MARKETING

Mr. Hanish brings over twenty years of experience in the firearms industry, as both a top sales executive for several leading providers of equipment (Surefire, LLC and FN America) and a competitive shooter. Hanish most recently served as the Vice President of Surefire overseeing the sale of suppressors, illumination devices and hearing protection in the Commercial, Law Enforcement and International Markets.

STEVE HILKO – COO, AMMO INC. MUNITIONS OPERATIONS (PAYSON)

Mr. Hilko leads factory and product development. Steve has 40 years of experience in manufacturing, engineering and supply-chain logistics and is a gun expert widely recognized in the ammunition industry.

JIM MANN – GENERAL MANAGER, JAGEMANN MUNITION COMPONENTS (WISCONSIN)

Mr. Mann has been with Jagemann Stamping since 2002. During his tenure he served as logistics support, manufacturing leadership, and in 2017 was promoted to General Manager of Jagemann's Brass Casing Division. He has extensive knowledge in continuous improvement, Lean/Six Sigma and project management.

ROB WILEY – CFO

Mr. Wiley, prior to joining AMMO, Inc. as the Controller in 2018, was a corporate tax accountant at Moss Adams, LLP. Mr. Wiley is a CPA and earned his Master of Taxation at Arizona State University.

These are talented and experienced players who know how to play this game well and have an enviable track record of success. You can read up more on Wagenhal's origin story [here](#). The guy is an impressive serial entrepreneur.

The stock is too small for our MO portfolio (we couldn't build a reasonable position without moving the price substantially) but I'm considering buying some for my PA. There's a lot to like about their product and at current valuations, there's a reasonable margin of safety built into the price. Might make a good long-term holding for a patient investor.