MACRO OPS

RESEARCH

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Ammo, Inc. (POWW)

Business Description: Ammo, Inc. designs, develops, manufactures, markets, and sells ammunition products primarily for the sporting industry in the United States and internationally. It provides ammunition in the form of cartridges or rounds for use in handguns and long guns. The company offers STREAK Visual Ammunition that enables shooters to see the path of the bullets fired by them; One Precise Shot ammunition, which is designed to meet various engagement scenarios experienced by law enforcement personnel in the line of duty; and Stealth Subsonic ammunition that is designed primarily for suppressed firearms. - *TIKR.com*

Thesis: Ammo, Inc. (POWW) is a fast-growing ammunition maker designing innovative products in a commoditized industry. The company's growing top-line revenue at a rapid clip while investing all their earnings into expanding manufacturing and production. POWW went from $4.6M in revenue in 2019 to $14.5M in FY2020. Management expects $30M in revenues next year. Future revenue growth will come from retail expansion and military contracts.

Past financials mean nothing when analyzing POWW. The company's investments in manufacturing and production distort short-term earnings, showing massive net income losses. Margins should rapidly expand as the company reduces its fixed-cost investment and ramps up revenue. Going forward, incremental revenue should be accretive to bottom-line cash flow and earnings.

We see a path towards $70M in sales by 2024, $9M in EBITDA and over $4/share in shareholder equity. Insiders seem to agree with our bullish thesis as well. CEO Fred Wagenhauls has spent most of April buying stock on the open market.

POWW's Products: Proprietary Ammunition for Recreational & Military/Law Enforcement

POWW's a simple business. They manufacture high-performance ammunition for two markets:

- Commercial / Retail
- Military / Law Enforcement

Combined, these two markets offer an $8B addressable market in the United States. Spanning outside the US, POWW estimates $30B in addressable market between the two segments.

The company makes money by selling proprietary ammo (STREAK, etc.), standard ammo and ammunition casings (which we'll discuss later). The company did $6M in sales of casings and $3.6M in ammo sales for 9M 2019.

A large addressable market is nice, but what's great about POWW's products? They're high-performance, high-margin and patent-protected.

Let's start with their *Streak Visual* ammunition. STREAK uses patented technology (One Way Luminescence (OWL) Technology) that enables a shooter to trace their bullet with *a* non-incendiary tracer on the back of the shell. In other words, when you shoot a STREAK bullet, you can visually see the bullet's path via a red light. The video footage is incredible, watch it here.

The technology behind STREAK ammo is important to the commercial/retail community for two reasons:

1. The tracer is non-incendiary (i.e., they don't generate heat)
2. STREAK is the only tracer that's allowed to be shot in indoor/outdoor firing ranges because its tracers don't pose a fire hazard.

POWW manufactures other brands of ammo such as:

- Black Label: ball and hollow-point ammunition
- Stealth Subsonic: ammunition for silencers
- Hard Armor Piercing: Military-Grade Ammunition

POWW's Retail Product: Better Than Competition

The company's golden egg is their OWL technology patent. This patent enables POWW to produce the only non-incendiary tracer bullet on the market. That's quite a competitive advantage.

Most first-time customers turn into super-fans of the ammo. Many suggested they'd buy more boxes, even though POWW's prices are marginally higher. This brand loyalty and recognition can't be stated on a financial statement -- yet it's a leading driver of our thesis.

As more people are introduced to the STREAK technology, we anticipate a growing fanbase adoption.

POWW's products are priced at a premium. This allows them to make higher-than-industry gross margins while marketing their ammo as higher-quality. In their latest investor presentation, POWW showed a 35% product margin target. That's 15% higher than the industry average.

The company distributes their retail product through three main channels:

- Two-Step Distributors — Ex: Graf & Sons, Zanders, Crow, Big Rock Sports (new)
- Mass Merchant/Online —Ex: Cabelas, Gander Outdoors, Bass Pro Shops
- Buying Groups — Ex: Sports Inc., worldwide, Mid-states

The company's seen a dramatic increase in distributor orders since April. For example, POWW expanded into 201 additional retail stores in the first quarter of the new fiscal year. 150 of these additions came via Rural King and Murdoch's Ranch & Home Supply locations.

This is just the start of a rapid, wide-scale expansion into every corner of the United States ammo market.

But retail/commercial is only one of POWW's two market strategies.

Military & Law Enforcement: The Real Growth Driver

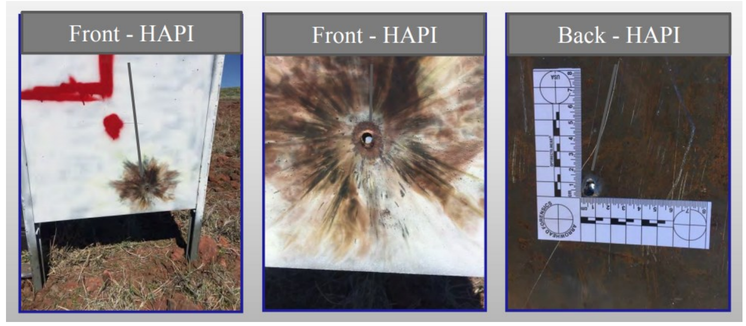
The military and law enforcement market will drive most of POWW's future sales growth over the next five years. For one, it's a much larger market -- $5B greater than its US retail market. Second, POWW's ammo offers real advantages in the combat zone.

Let's take POWW's Hard Armor Piercing Incendiary (HAPI) bullets. The company's HAPI bullets combine POWW's two patented strengths:

- OWL Technology
- Armor-Piercing technology

POWW added to its proprietary technology by acquiring SW Kinetics in 2018. SW Kinetics is behind the company's armor-piercing ammo offering to military and law enforcement.

HAPI is arguably the best military-grade ammo product on the market. HAPI rounds don't use explosive charges to pierce armor. Instead, they use chemical and mechanical reactions with the armor to penetrate up to **half an inch** of solid armor.



No other competitor can claim full armor penetration at 1,000 yards. Plus you can see the bullet travel to its target via OWL technology. The company currently makes HAPI bullets for machine guns and sniper rifles.

The company's seeing increased demand from the military market. Here's CEO Fred Wagenhaul's comments from mid-April (emphasis mine):

> "**We anticipate orders from the military and law enforcement channel, both domestically and internationally, to ramp up in our first quarter of fiscal 2021.** We are constantly receiving strong interest in our innovative and technologically advanced ammunition from potential partners, and we believe our expanded capacity will allow us to fulfill anticipated military and law enforcement purchase orders as we continue to gain traction in this channel."

One caveat is that military orders are lumpy in nature with long sales cycles. Going forward, POWW's military segment should provide large but lumpy revenues. To use a baseball analogy, the retail segment gets singles and doubles. The military segment hits home runs.

Before thinking about the next five years of revenues and earnings, we need to talk about POWW's hidden asset: Jagemann Casings.

Jagemann Casings: Diversification, Integration & Lower Costs

POWW bought Jagemann Stamping's Casing & Projectile Manufacturing business in March 2019. Jagemann is a leading brass casings manufacturer and has a long history of producing high-quality casings.

POWW paid $17.4M in cash plus 4.75M common shares for the business. So what did AMMO receive for nearly $24M total investment (at the time of issuing shares)?

For starters, Jagemann provides the company with vertical integration capabilities. These vertical initiatives assure the company of a 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.

It's not just vertical integrations and cost savings. Jagemann's Casings division will generate $20M+ in annual revenue over the next five years.

Adding the casings company also enables POWW to rapidly develop new products thanks to their integration between manufacturing and assembly. Over time, this will increase POWW's technological advantage and leave its competitors far behind the curve.

A Jockey Bet: Fred Wagenhals

A company this small ($80M market cap) requires a bet on the jockey. Luckily for us, POWW's jockey is pretty good.

Fred Wagenhals is a serial entrepreneur. His former claim-to-fame was Founder of Action Performance Companies. The company sold NASCAR-branded products. Between 1993-1997, Wagenhals grew revenues 8x, from $15M to $130M.

In his prior venture, Wagenhals used a buy-and-build strategy. For example, at Action Performance, Wagenhals bought marketing companies to promote his products. He also bought-out smaller customers in adjacent markets (such as Formula1 racing and plastic model race car kits). By the time it was over, Wagenhals controlled 50-60% of the entire die-cast collectible race-car market.

He eventually sold Action Performance to Motorsports Authentics for a reported $245 million. The guy also won $1 million playing the lottery, so he's got luck on his side. Encyclopedia.com has a great history of Wagenhals' time at Action Performance. You can find that here.

Wagenhals is poised to recreate the eight-fold revenue growth he oversaw between 1993-1997. He has tremendous skin in the game, owning 16% of the common stock while taking a modest, $120K salary.

Trailing Earnings Don't Tell The Story, It's Revenues

At first glance, POWW seems like a terrible investment. They lost $5.7M in 2017, $1.80M in 2018 and $11.10M in 2019. That's about to change.

Backward-looking analysis does the investor no good with POWW for two reasons:

1. POWW needed to spend a lot of money to get their operations/systems in place.
2. These investments will decrease dramatically over the next five years.

What we care about is revenue growth. And they've got it in spades. POWW's grown top-line revenue 1,150% since 2016. Noted earlier, they grew 218% **this year**. The company's operating at 115% capacity with workers pulling seven-day-a-week double shifts.

This increased capacity and production come at a cost, though. POWW's paying those costs up-front. The company recently announced two major investments:

- $200K installation of two manufacturing machines at Payson, AZ plant
- $750K installation of additional tooling equipment in Manitowoc facility

So no, you won't find this stock on some traditional value-based screener any time soon. Investors shouldn't focus on earnings -- focus on revenue growth and gross profit growth. As we'll see later, the earnings (should) follow.

Valuation: Back of Envelope 2024 Picture

There's a lot we don't know about the future of Ammo, Inc. We know we'll see large sales growth over the next five years. But what about margins? What about profits? We can take a sales multiple approach and look at potential free cash flows in 2024.

In our model, we're assuming 40% growth in 2022, 40% growth in 2023, and 20% growth in 2024. That gets us $70M in 2024 revenues. That's a conservative estimate given the increased demand POWW's seen over the last month.

Under this scenario, we're looking at 2x 2022 sales assuming 40% growth.

What's an appropriate sales multiple for a company growing revenue 40%+/year over five years? 5-7x? Remember, the company has durable technological advantages against its competitors.

Over the next five years, POWW will likely lose money on a free cash flow basis. This means all our equity value is in its terminal value. Using the above multiples gets us between $243M - $340M in Enterprise Value. Subtracting debt from each scenario gets us an average shareholder equity value of around $4.85/share.

(USD in millions)		*Model*	
	Low	Mid	High
Enterprise Value	186	234	283
(+) Cash & Short Term Investments	0	0	0
(+) Investments & Other	0	0	0
(-) Debt	(11)	(11)	(11)
(-) Other Liabilities	0	0	0
(-) Preferred Stock	NA	NA	NA
(-) Other	0	0	0
Value of Common Equity	174	223	271
(/) Shares Outstanding	46	46	46
Implied Stock Price (USD)	3.80	4.85	5.91
FX Rate: USD/USD	1.00	1.00	1.00
Implied Stock Price (USD)	3.80	4.85	5.91
Upside / (Downside)	123.3%	185.5%	247.7%

Risks: Small, Young and Not (Yet) Profitable

There's a lot of risk with POWW. Our long-term bet is based on loads of revenue growth that if stalled, would dent the bull thesis.

Another risk is CEO dependence. POWW is Fred Wagenhals' baby. A departure, step-down or hint of other activities would shoot holes in our ability to trust management.

Third, you need raw materials to make ammunition. Yes, it helps to own a casings company. But that won't protect POWW from rising raw materials costs. Any substantial rise in raw materials will negatively impact gross margins.

Finally, POWW relies on external financing to sustain its current operations. As revenues grow and margins expand we should see the company ween off the public markets teet. We're keeping a close eye on share dilution and long-term debt issuance.

Chart Set-up: Trend Reversal In Action