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An Equity Note

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What's Inside:

- POWW reported Q2 2022 earnings and crushed it.
- POWW generated $61M in revenue w/ $16.8M from GunBroker.com
- Raised FY guidance on revenue and EBITDA
- Analysis on earnings, new Tegus calls and valuation model

Companies Mentioned:

- Ammo, Inc. (POWW)
- Vista Outdoors (VSTA)

MO Equity Note: POWW Earnings & Why The Stock Has 17% Short Interest

One of our largest core holdings, Ammo Inc (POWW), reported earnings this week.

The company broke prior records for revenue growth, EBITDA, and operating profit margins. The GunBroker marketplace generated its first quarter of high-margin revenue. POWW's latest 160K square foot ammunition facility is ahead of schedule and under budget.

Everything's humming along nicely. Except for the stock price.

This week we're diving into POWW's earnings report. We'll discuss the stock's massive 17% short interest ratio and reasonable bear case arguments.

We'll also highlight a few comments from two new POWW Tegus calls, both of which provide incredible insights into the company's inner workings.

Finally, we'll update our thoughts on valuation with our latest MOCRO Report.

Let's get after it.

POWW Q2 2022: A Record Quarter On Every Front

POWW crushed Q2 earnings on every front. Here are some highlights:

- Net revenues increased 408% to $61.0 million
- Generated $16.8M in Marketplace revenue
- Gross profit margin was 43.0% compared to 10.7%
- Net income was $14.1 million compared to a net loss of $2.3 million
- Adjusted EBITDA was $24.0 million versus $0.4 million
- Backlog stands at $185M

Q2 was also the first *full* quarter for GunBroker.com revenues, which accounted for 28% of total sales. Increased Marketplace sales also led to higher gross margins, up from 10% to 43%.

Additionally, if you back out the $3.3M non-cash depreciation and amortization expense from the GunBroker transaction, POWW generated $17M in net profits. **That's a 28% profit margin.**

Looking ahead, the company raised both revenue and EBITDA guidance on a full-year basis. Revenue rose from $210M to $250M and EBITDA from $70M to $80M.

POWW would trade at ~3x sales and ~9.3x EBITDA should it hit those year-end goals.

Let's shift to a couple of operational updates.

GunBroker.com, New Production Facility & Vista Partnership

Browse most gun-buying forums, and you'll read a generic sentiment, "*GunBroker is by-far the largest player in the space, but their customer service sucks and there's loads of scammers on the platform.*"

Here's the founder of a 2nd Amendment Arms Ammo LLC explaining the issues with GunBroker in a recent POWW Tegus call (emphasis mine):

> *"On that platform* ***people are putting stuff out there that either they don't own, or they're going to get it in stock.*** *So people are trying to buy, and then they're told, once they make that purchase, they say, oh,* ***you're going to have to wait six months.*** *But like eBay, you expect to get it within a week. It's not going to happen."*

Despite the above issues, the company added 50,000 new GunBroker memberships per month during the quarter. Member growth is excellent. But it can also amplify existing problems (like scammers and customer service).

I asked Wagenhals about POWW's investment in customer service during the conference call. Here's his answer (emphasis mine):

> *"So we've been spending a lot of time there [on customer service]. As you mentioned,* ***we've been adding people, doing significant training****, doing some serious catch-up and trying to make the whole process easier for the end user.*
>
> ***So it used to be just through e-mails. Now there's -- we actually talk to live people.*** *They're doing a miraculous job in catching up, let's say, in the customer service arena."*

Management knows the issues at hand, and they're actively fixing them.

Speaking of brands, it's *evident* that GunBroker is the dominant marketplace for firearm and equipment sales. According to SimilarWeb, GunBroker generates ~15.5M monthly visits. Their next closest competitor, GunsAmerica.com, sports ~2.3M monthly visits (a near 7x lead).

POWW's also experimenting with loyalty programs and credit card offerings to improve the GunBroker member experience. Here are Wagenhals' thoughts from the earnings call (emphasis mine):

> *"We believe with the **credit card program**, the l**ateral credit program** and the new **loyalty program** we're putting in place, as well as looking into **Bitcoin programs**, we believe these monthly numbers will increase dramatically."*

These investments in GunBroker will take time, but the potential payoffs are incredible.

POWW is the only ammunition company fostering a D2C relationship with its customers through an online marketplace. If they get this right, they'll have the highest operating margins in the industry for decades.

Alright, let's shift to the new production facility.

The company is on-time and under budget with its massive 160K square foot ammunition production warehouse. Once complete, POWW will have the capacity to manufacture <u>1 *billion* rounds of ammunition.</u>

You can follow the facility's construction progress here.

POWW's goal is to create the most automated ammunition facility in the country. So far they've automated the packaging process of 1 SKU and updated automation on the STREAK annealing oven process (saving $0.01+/round).

Finally, there's POWW's new barter/partnership with Vista Outdoors. The company signed a 5 year deal with VSTO to exchange casings for primers. The partnership ensures a steady supply of primer in a supply-shortened cycle.

Despite the killer earnings report, the stock opened *down* 7%+ on the next trading day. What's holding the stock back?

POWW's 17% Short Interest & Bear Thesis Arguments

Investors are short nearly 18% of POWW's available trading float. Check out the data from Fintel.io below.

Short Interest Ratio	3.35 Days to Cover
Short Interest % Float	17.97% - source: NASDAQ (short interest), Capital IQ (float)
Dark Pool Short Volume	529,289 shares - source: FINRA
Dark Pool Short Volume Ratio	51.62% - source: FINRA

Such high short interest begs the question: **What do the shorts see that the bulls are missing?**

There are a few reasons why someone would short POWW:

- Management (Fred Wagenhals) was involved in a promotional scheme in 1999
- The company is a commodity manufacturer and should trade like one
- GunBroker acquisition isn't as great as bulls think (loads of scammers and terrible customer service)
- Lack of industry veterans within the company (little experience)
- Rising raw materials prices will compress gross margins

Let's deconstruct each argument.

Management (Fred Wagenhals) was involved in a promotional scheme in 1999

Fred Wagenhals was accused of over-promoting/pumping his first company, Action Performance, in 1999. You can read the court documents here.

Here were the results of the accusation:

- Claims against Action Performance were **DISMISSED**
- Claims against Fred Wagenhals were **DISMISSED**

This accusation highlights an essential aspect of Wagenhals' character: Fred is an old-school entrepreneur, a promoter, and a go-getter.

Here's how one former VP of Business Development explained Fred (emphasis mine):

> *"Fred I mean, **he's a diehard. He's an old school business gu**y that is just, I mean, he's the **first guy in the office and probably would stay until the end of the day if it wasn't for his seasoned age**, yes, he's an entrepreneur."*

We see Fred's diehard style in how he manages POWW. For example, it seems commonplace now for management to "beat and raise" every earnings season.

That "beat and raise" mentality starts with Wagenhals. The former VP of Biz Dev confirms our thesis (emphasis mine):

> *"I mean so Fred is great because as a business owner, right, **he always wants more**. But sometimes you need to kind of back Fred down and step in and talk logic more than hopes and dreams, right? Like they put a goal in place in 2020. **And immediately, they were like, oh, we're going to do more** than that, we're going to **double that goal.** And he's just started talking about how we're going to **double that goal.** We're going to **double that goal.**"*

So far, Wagenhals' go-getter strategy has worked. But we'll be quick to react should POWW start missing quarterly revenue and EBITDA guidance targets.

The company is a commodity manufacturer and should trade like one

POWW is in the early innings of developing its GunBroker marketplace. And yet, the company still *screens* like a traditional ammunition manufacturer.

How would you define POWW if you're MorningStar or Bloomberg? Is it an ammunition manufacturer, an online marketplace, or both?

There's no easy definition. And it's in this gray area that investors misrepresent the company.

You can't call a business that generated 63% of its operating profit from an online marketplace a "commodity manufacturer."

GunBroker acquisition isn't as great as bulls think (loads of scammers and terrible customer service)

We addressed this issue earlier. POWW is actively fixing customer service by offering real-life human phone calls, loyalty programs, and potential Bitcoin payment offerings.

Bears see an ammunition company trying to pivot into something that's not their wheelhouse. Here's how the former VP of Biz Dev put it (emphasis mine):

> *"I've been doing it for a year, and it's just not something, there's people that are good at baking a cake and they should bake a cake and there's people that are good at cutting down tree, they should stick to that.*
>
> *They should stick to selling it to dealers and two-step distribution and not try and get involved in dealing with customer service."*

Luckily there's nowhere to go but up when it comes to improving customer service at GunBroker.

Lack of industry veterans within the company (little experience)

One common negative surrounding POWW is that the company's short on industry veterans. The company's oldest industry veteran, Steve Hilko, retired this year. He worked with Wagenhals for 40+ years and was getting up in age.

However, that's also a great thing. Ammunition manufacturing is an antiquated industry that's lacked innovation for decades. Fresh blood like Wagenhals and company could provide the much-needed catalyst for industry change.

Rising raw materials prices will compress gross margins

POWW isn't immune to rising raw material costs on its final product. Add to that increased demand for ammunition, and you get a twin-engine of gross margin issues.

That said, POWW is taking proper steps to mitigate such pressures. For example, they make their brass casings in-house (via Jagemann acquisition). They also use brass casings to barter for primer with Vista Outdoors.

So far, the company has passed rising input costs onto its customers. But that won't last long. During our weekly meeting, Alex noted that .223 ammo costs ~$2/round.

And while gun enthusiasts tend to have inelastic demand curves for ammo, there's *always* an uncle point. There's a non-zero chance ammo prices reach such high levels it forces enthusiasts to halt purchase orders.

Wagenhals did make one interesting comment on raw materials during the conference call. Here's what he said when I asked him about capital allocation decisions (emphasis mine):

> *"I would be -- I would not be telling the truth if I didn't say **we were looking to be a little more vertically integrated.** And with the additional space, I think you'll probably **see that happen in the not too distant future.**"*

Over the long term, Wagenhals wants to replicate what he did with Jagemann, but for every other aspect of ammunition manufacturing. This will take time and requires investor patience. But it shows that management's thinking about the problem in the right way.

Thinking About Valuation: Updating Our Priors

Sometimes a company blows you away with what they deliver compared to initial estimates. POWW is that company. Check out our initial valuation hypothesis from 2020 (emphasis mine):

> *"We see a path towards $70M in sales by 2024, $9M in EBITDA and over $4/share in shareholder equity."*

POWW will likely do *at least* $70M in EBITDA this year and over 3.5x our estimated initial revenue. Oh, and they'll do it two years before we thought.

You can see our updated MOCRO valuation model here.

It's important to highlight that the stock currently trades at our estimated **Bear Case** valuation estimate. Our **Bear Case** also assumes the following 2031 figures:

- $380M in revenue
- $124M in gross profit (at 32% margins)
- $46M in EBIT (at 12% margins)
- 1.5x EV/Sales Multiple

- 15x EV/EBIT Multiple

In other words, the stock is trading as if it will add only $13M in annual revenue between 2022 and 2031.

In fact, our blended estimates (which includes Base, Bear, and Bull) show a roughly 20% 10YR IRR at the current price.

We'll continue to monitor POWW's progress and adjust our priors. As it stands, the odds of POWW living our Bear Thesis remain small.

The stock remains in a long-term sideways range between $6 and $10/share.

We'd like to add on a failed breakdown or a return to its uptrend after finding support on crucial moving averages (50 & 200 day).

Hypothetical 10YR IRRs	
Invest Date	2021
Exit Date	2031
Hold Period (y)	10
Year 10 Share Price	
Base Case	$12.90
Bear Case	$5.77
Bull Case	$40.38
10 Year IRR	
Base Case	9.91%
Bear Case	-1.10%
Bull Case	52.32%
Blended IRR	20.38%