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An Equity Note

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What's Inside:

- ➢ POWW Earnings Update
- ➢ AUTO Earnings Update
- ➢ New Buys & Sells
- ➢ Updated Stop-Loss Positions

Companies Mentioned:

- ➢ Ammo, Inc. (POWW)
- ➢ AutoStore (AUTO)

MO Equity Note: POWW & AUTO Earnings Blitz

Happy Saturday!

Earnings Week is in full swing, and we've got a couple of names to unpack this weekend:

- **Ammo, Inc. (POWW)**
- **AutoStore (AUTO)**

For the most part, the market *has* been fair. It's destroyed the stock prices of nearly *every* company that reports earnings, good or bad!

We're happy to wait on the sidelines as some of our favorite names trade lower despite improving business fundamentals.

We'll also review any trades made during the week, update position stop-losses, etc.

Let's get after it.

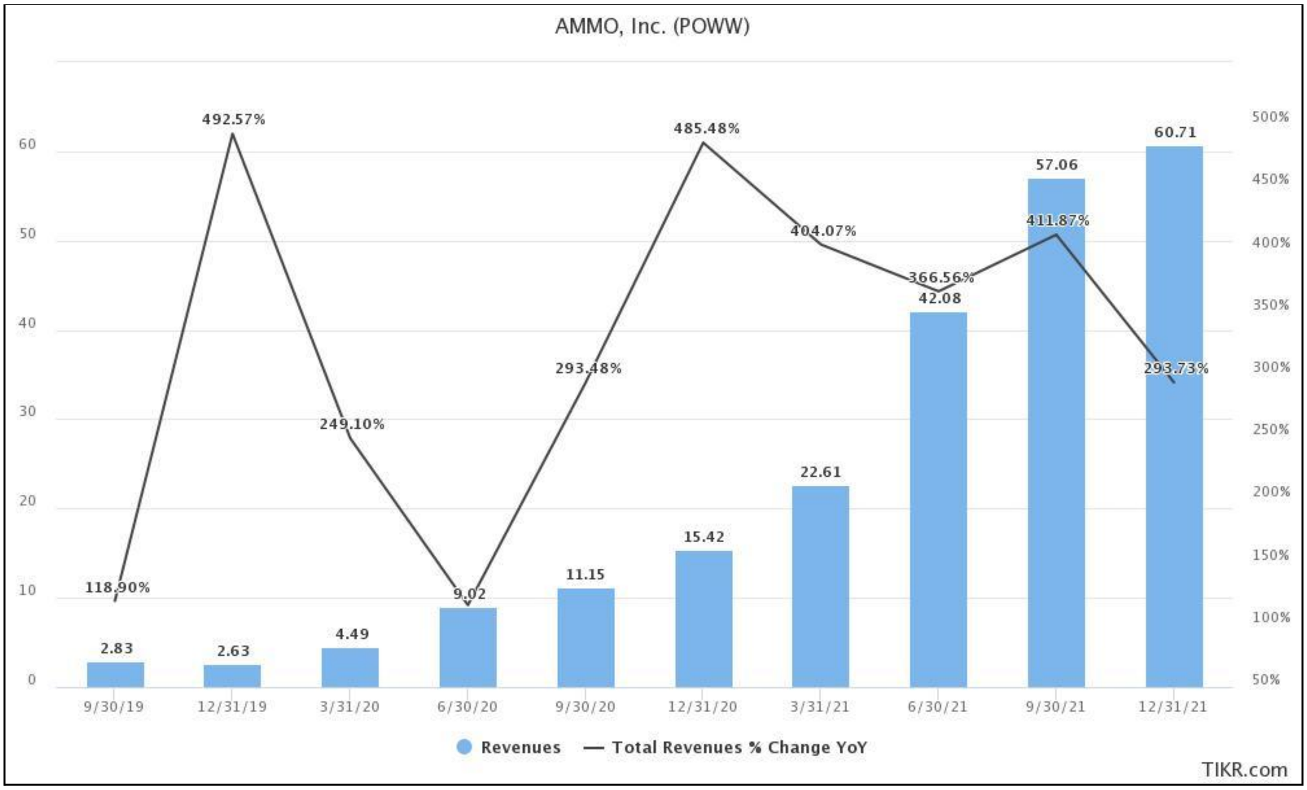
Ammo, Inc. (POWW) Earnings: Yet Another Triple-Digit Growth Quarter

POWW reported Q3 2022 earnings on Monday (02/14) and crushed it. Here's a taste of what they accomplished:

- ➢ Increased revenues by **289%** to $64.7M
- ➢ Gross Profit Margin improved by **1,500bps** to 38.4%
- ➢ Generated **$9.1M in Net Income** versus -$1.9M (YoY)
- ➢ Grew Adjusted EBITDA by **752%** to $20.1M

The company continues to execute on its high-growth strategy while generating incrementally higher marketplace margins.

Meanwhile, the 289% revenue increase is just one of *many* triple-digit growth rates. Check out POWW's revenue growth over the last ***ten*** quarters:



Let's turn to the company's marketplace business, GunBroker.com (I discussed my latest thoughts on GunBroker here). Check out the highlights below (YoY basis):

- Generated **$17.6M in revenue**
- Growing new users by **~55,000/month**
- Number of auctions increased **by 33.4%**
- Increased average take rate to **5.4% versus 4.6%**
- Loyalty program revenue increased by 8.8%

We outlined GunBroker's importance last week, saying (emphasis mine):

> *"POWW is increasingly becoming a bet on GunBroker.com, which is good for shareholders.*
>
> *GunBroker allows POWW to generate marketplace-like margins selling (what is otherwise) a commodity product.*

> *Competitors can't match POWW's value proposition.* ***They can't sell ammo at 40%+ gross margins because they don't have direct relationships with customers*** *nor an online marketplace with millions of registered users.*
>
> *This is important because margins will compress as more ammunition supply comes online. Margin compression hurts a lot more when you're making 10-20%, not 40-50%.*
>
> *Additionally,* ***GunBroker insulates POWW from its industry's typical supply-demand cycles, allowing it to capture a more stable gross margin profile over time.*** *Higher, more stable margins should lead to an above-average market multiple."*

There are a couple of nuances in tracking GunBroker's performance. The first (and obvious) data point is the total share of revenue. For example, GunBroker generated ~27% of POWW's total revenue this quarter.

Ideally, you'd want GunBroker's revenue share to increase over time, resulting in higher gross/EBITDA margins. However, POWW's manufacturing revenue *should* increase, potentially at higher rates than its marketplace business. Especially if it wins myriad military contracts.

In other words, GunBroker's total revenue share matters *in context* to POWW's manufacturing growth. We'd *gladly* take a lower GunBroker revenue share if it meant more military contracts, etc.

Let's shift to the earnings call.

Some Thoughts From POWW's Earnings Call

Fred Wagenhals started the call with an overview of the company's latest successes. I particularly enjoyed this bit (emphasis mine):

> *"As we noted in our recent revenue guidance for a full year of fiscal 2022 of $250 million, we see no slowdown in demand for our ammunition.* ***At our current production levels, our entire production is completely sold out for 2022.***
>
> *We are increasing production monthly and look forward to the completion of our new state-of-the-art manufacturing facility. This really will allow us to ramp up capacity quickly to meet customers' demand. We continue to invest in people and manufacturing equipment as we prepare to launch our new facility."*

POWW quarterly reports fall on wonky dates. For example, POWW reported Q3 2022 earnings when most companies reported Q4 2021 or Q1 2022.

This means that POWW is sold out for the remainder of the *fiscal year*, or roughly one quarter's worth of demand. Still good, but not as great as 100% booked on a calendar year basis.

Regarding demand, POWW management sees no slowdown ahead for its ammunition products. Here's Rob Goodmanson's explanation (emphasis mine):

> *"I think you'll see, Eddie, that the capacity is still not caught up to the demand. It has not slowed for sure.*
>
> *We're not seeing that with the addition of all the new shooters over the last number of years. I know you probably saw a report from Smith & Wesson that they were -- their inventories were up,* ***but we are not in the gun business. We're in the ammunition business.***
>
> *We're just not seeing the slowing yet."*

One way to think about the gun/ammo business is like the printer business. You buy a printer (gun) once but routinely order new ink cartridges (ammunition) to replace the ones you've used.

<u>The only difference is people don't stockpile HP LaserJet printers in a zombie apocalypse.</u>

Then there's the new manufacturing facility. Check out the latest updated pictures (from Jan 2022):

According to Wagenhals, the facility is on-time, under budget, and should open this Summer. The new facility will bring *massive* relief to the company's current infrastructure situation.

During the call, Wagenhals explains how the company is basically operating with a hand tied behind its back (emphasis mine):

> *"**I don't think anybody understands what we've went through to make the numbers that we just posted.** I mean we're a company right now that's **running 3 different buildings, traveling 10 miles from one building to the other**.*
>
> *We've got **2 shipping docks versus 8 when we get to our new building.** We've got trucks lined up to receive merchandise. We got trucks waiting to take merchandise out. So our people have done one hell of a job in accomplishing this goal under the circumstances that we now work under.*
>
> *So I mean if you went to our place now, **it's people standing on top of people**, making products."*

<u>That POWW has generated nearly a 300%+ increase in revenue while its manufacturing operates with one hand behind its back is a testament to management's *exceptional* ability to deliver throughput to customers.</u>

I also had the chance to ask POWW's management a few questions regarding share issuance, capital allocation, and general industry worries.

Check out the exchange below (emphasis mine):

> ***Brandon: "****So is it reasonable to assume that* ***we shouldn't necessarily see any more dilution going forward****, barring any sort of special one-off acquisition, where it maybe would make sense to kind of pay for some of that in stock."*

> ***Robert Goodmanson:*** *"****At this point, we have no plans to issue any more stock.*** *That doesn't mean it couldn't happen for, let's say, another acquisition, GunBroker like type, but this is one of the -- also one of the reasons why we do the share buyback to get fewer shares out there, make the value there, and we think we'll make there was a solid decision to make just because of where it was trading and what we think the actual value of the shares are."*

Share issuance is among the most popular questions FinTwit investors ask when discussing POWW. Potential investors *love* the growth, insider ownership, and guidance. But they hate the fervent share count expansion.

Here's my take: **Share issuance is accretive (and sometimes necessary) for early-stage growth companies as they execute on their long-term growth prospects.**

POWW used its shares as currency to vertically integrate its operations (Jagemann Casings) and to acquire a high-margin, direct-to-consumer marketplace (GunBroker).

That said, things are different now. POWW is generating *positive* GAAP profits. They're paying dividends on preferred stock (POWW.P). The company now has the cash generation and balance sheet to internally finance growth.

Any share issuance outside of accretive acquisitions should be met with intense skepticism.

Finally, I asked Wagenhals if there is anything that keeps him up at night. I love his response (emphasis mine):

> *"People. Number one, getting people to come to work every day. And number 2 would be, since I years old, I guess, keeps me up is stock price.*

> *I'd like to see it higher,* ***but I learned a long time ago, it's just a matter of keeping blinders on and focusing on your business and keep making money and keep making earnings and don't do anything stupid and make accretive acquisitions if we're going to make one.***

> *And eventually, the stock price will be what it should be."*

We're still long our ~4% notional position with an initial stop-loss around $3.95 (most recent pivot low). The stock is in a bear quiet regime on the daily time frame. We'll add to our position on future bullish price action.

AutoStore (AUTO): A Record-Beating Q4 Report

AutoStore (AUTO) is an Automated Storage and Retrieval System (ASRS). It uses patented robotic technology to provide 24/7 order fulfillment capabilities at a fraction of the storage space.The company is the industry leader, with over 35,000 robots working across 800+ installed units.

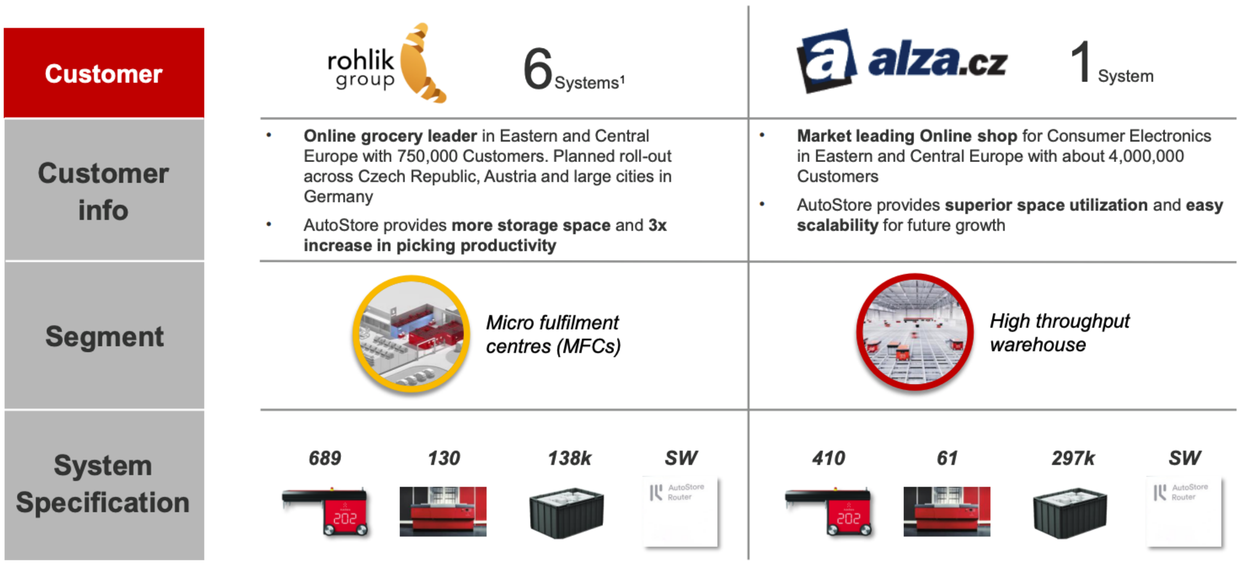
We first wrote about the company in November 2021, which you can read here. You can also read our most recent updates on the company (here, here, and here).

AUTO reported Q4 2021 earnings Thursday (02/17). You can check out the earnings presentation here. The company crushed both internal and analyst estimates. Check out the highlights:

- Revenue increased by 58% to $93.2M
- Generated $328M FY 2021 revenue (beating $300M expectations)
- 44% Adjusted EBITDA Margin
- Increased Order Intake by 126% to $198.4M
- Order Backlog of $456M, up from $159M YoY

The company installed another 124 systems to reach a total installed base of 894. That's >44x more than its closest competitors combined (Ocado + smaller players). 70% of the new installs came from new customers (30% existing).

AUTO outlined two system installation wins during the quarter (see below):



These are *massive* projects. For example, AUTO installed nearly 700 robots for *rohlik group* across 6 systems. The company then installed 410 robots and 297K storage bins for *alza.cz*.

Specifically, the *rohlik* contract shows that AUTO is *taking share* in the online grocery category – a space historically dominated by rival Ocado (OCADO).

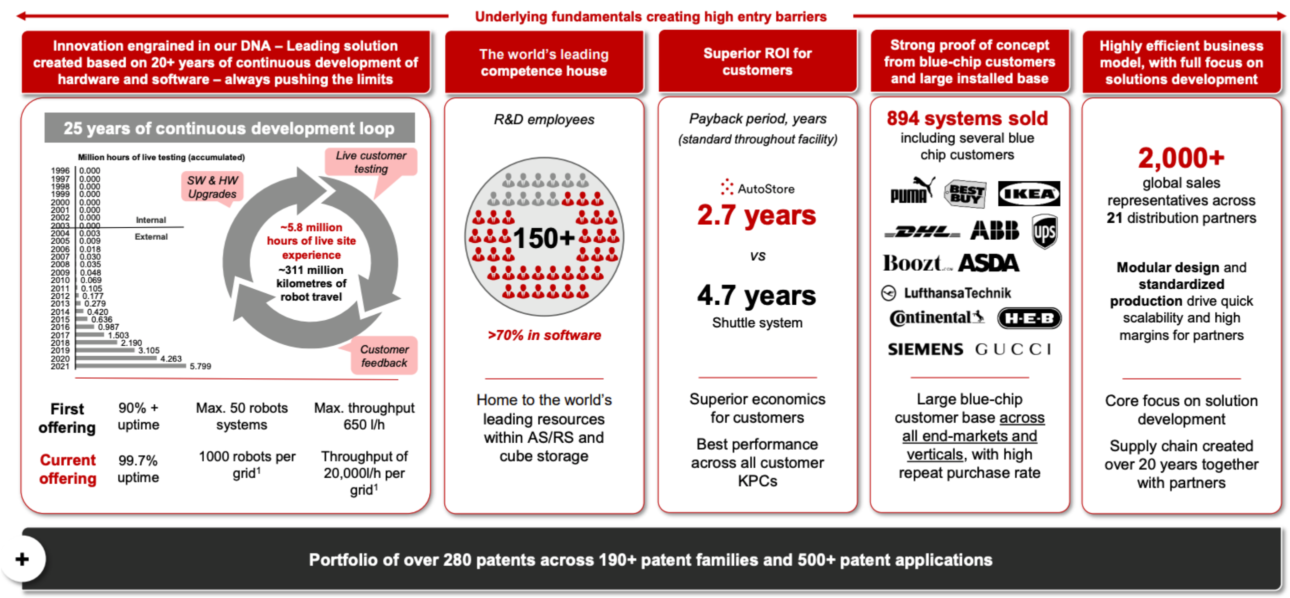
Reviewing AUTO's Growing MOAT

As the #1 leader in the cubic storage space, AUTO benefits from a few key advantages.

First, the company has 5.8 *million* hours of live site experience. AUTO can leverage that *defensible data* to improve its robots and grid system software. It's also *impossible* for competitors to match AUTO's live hour data lead.

Second, AUTO has 44x the number of installed systems compared to its competitors. This allows the company to generate more revenue, which enables higher reinvestment in R&D to improve its product offering. We see this in AUTO's ~2.7 year payback period versus its competitors' payback of 4.7 years.

Third, higher R&D investment means customers stick (and expand) with AUTO's products versus other competitors' offerings. This reinforces the above flywheel of higher revenues and higher technology reinvestment.



AUTO's self-reinforcing moat *should allow* the company to hit its 40%+ revenue growth target over the next few years at 40-50%+ EBITDA margins.

The company plays in a $230B sandbox and is now taking share in online grocery. Talk about an incredibly long organic growth runway!

AUTO's Sales Force: A Chance At Even Higher Margins

As you can see above, AUTO leverages 21 global distribution partners with 2,000+ external sales representatives.

For example, distributors like Dematic sell/install AUTO's products to its end customers. Distributors *love* AUTO's products because they earn higher margins, sometimes higher than their *own* products!

One former Dematic Senior Director explained the decision process (emphasis mine):

> *"And a lot of the time, **it's easier to go with the AutoStore because you know it's going to be right.** You know the number, you know it's fruitful, you know how to do it, and it's just there ready to go, and there's a lot more. There's not much risk based there."*

AUTO *could* capture some of that margin it divests to distributors if it had its own sales force. Fortunately, management explicitly said during the earnings call that ***it was building its own sales force team.***

The company's distributors also know how much margin AUTO could capture with an internal sales force. Let's go back to the Dematic director (emphasis mine):

> *"I have the relationships with some of the key players in the industry, bring it into house. And yes,* ***they would be very much successful because ultimately, they could keep increasing their prices and still have the same marginality*** *because at the moment, obviously, they're increasing their prices, that's dropping from our margin.*
>
> *Their marginality is staying the same, I'm sure.* ***But if you think about how much margin we're able to consult, that's all margin that they're losing out on.*** *So if they go back to basics almost and* ***put up their own service org and teams to be able to actually go out to market and be able to do that, and that's basically more margin, more profit in their pocket.****"*

Building an internal sales force team will take time and creativity. Build too fast and risk losing critical relationships with your 21 global distributors. Build too slowly and lose margin that can be used to reinvest and improve the product, increase more salespeople, etc.

We'll monitor the company's sales force progress over the next few quarters and update you on what we find.

Thinking About Valuation

AUTO has a *legitimate chance* at growing revenues by 40%+ over the next decade. The company has a head start against its competitors with the most extensive installed base in the industry.

Additionally, AUTO is investing *heavily* in product/software, with 70% of the company's full-time employees (FTEs) working in R&D.

The attack plan is simple: **install as many systems/robots with as many customers as possible next 5-10 years. Then, incrementally improve the product while insulated from competition due to high infrastructure switching costs.**

AUTO has executed its game plan flawlessly.

As such, we've increased our confidence in the company's bull case valuation to a **30% probability of success.** You can see our probability breakdown on the right.

Our current probability-weighted scenarios assume a ~39% 10YR IRR.

Hypothetical 10YR IRRs			
Invest Date	2021		
Exit Date	2031		
Hold Period (y)	10		
Year 10 Share Price			
Base Case	$14.15		
Bear Case	$3.58		
Bull Case	$31.71		
10 Year IRR		**Probabilities**	**Prob. Adj Ret**
Base Case	32.82%	40.00%	13.13%
Bear Case	0.83%	30.00%	0.25%
Bull Case	85.95%	30.00%	25.79%
Blended IRR	39.87%	**Probability Weighted IRR**	39.16%

It's important to remember that each scenario takes *substantial* EV/Sales multiple compression (from 20x+ to ~6x by 2031).

The stock rose ~11% after the company released earnings, falling equally as low on Friday. We'll likely enter a starter long position (risking ~3% notional) in the coming weeks.

Portfolio Updates

Buys and Sells

- **SELL** Full position in SmileDirectClub (SDC)
- **SELL** Full position in Carvana (CVNA)
- **SOLD SHORT** Russell 2000 Futures
- **BUY** Starter position in Asana, Inc. (ASAN)
- **BUY** Natural Gas Futures (NGH2022)
- **BUY** 10 YR Treasury Note Futures (ZBH2022)

Updated Stop-Losses

- **BFIT:** Initial Position to USD 43.32
- **NTDOY:** $59.00
- **VIST:** $6.00