An Equity Note

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What's Inside:

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Companies Mentioned:

- ➢ *Ammo, Inc. (POWW)*

Equity Note: What I've Learned From POWW (& My Call w/ Management)

I've spent the past two weekends outlining my growing impatience for POWW and its management team. You can read my thoughts here and here.

One of my grumblings was management's inability to respond to my calls. That changed this week.

In today's *Equity Note,* I share my notes from my conversation with POWW President Rob Goodmanson.

Though Rob was gracious enough to give me nearly an hour of his time, I left that conversation as I left POWW's latest earnings call; with more questions than answers.

Rob's comments reaffirmed my belief that management doesn't know what they're doing. That they're misallocating capital, and that there's likely *very* little chance Gunbroker sees its full potential under its current owners.

I'll also weave a few key lessons from my experience studying (and investing) in POWW and how we can more quickly spot company troubles before they cost us.

It's not often Mr. Market allows you to *earn* money while making mistakes. But we'll take it and run.

Let's get after it.

Notes From My Call with Rob Goodmanson

I divided the call into five main segments:

- ➢ ***Capital Allocation***
- ➢ ***Accounting Discrepancies***
- ➢ ***Profitability w/ Manufacturing Business***
- ➢ ***Accounts Receivables & Inventory Issues***
- ➢ ***Gunbroker***

I'll provide the question (Q), paraphrase Goodmanson's response, and add my commentary.

Capital Allocation

Q: *"You mentioned that you've allocated $2M to share buybacks, yet you didn't do any this year. I found this confusing since you suggested you'd print $100M+ in Adj. EBITDA, which implies a ~30% yield at current stock prices. Why is that?"*

Goodmanson: *"We haven't bought back stock here because we think we can turn that money over more quickly by investing in the business. The new manufacturing facility costs money, and we've financed that with $13M in cash and the rest with a construction loan.*

"Remember, we're still in the growth stage in our company's life cycle. So we'll do everything we can to ensure those dollars go into the business as long as they generate good returns."

Comments

Goodmanson's answer confused me for a few reasons.

First, if you're in the early growth stages of a company, why do a buyback at all? Why not just tell shareholders, "*hey, I know our stock is down. But we're still growing like crazy. So while it looks cheap, we prefer investing in our core business.*"

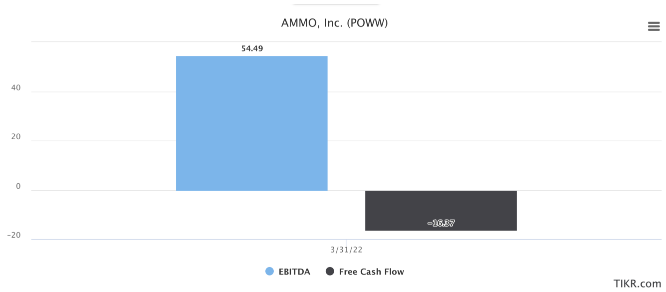
Second – and this is something I mentioned in last week's *Note* – when's a better time to buy your stock than at a 30% EBITDA yield?

The answer lies in my first **Lesson** from studying/investing in POWW.

Lesson #1: Follow The Cash, Forget The Rest

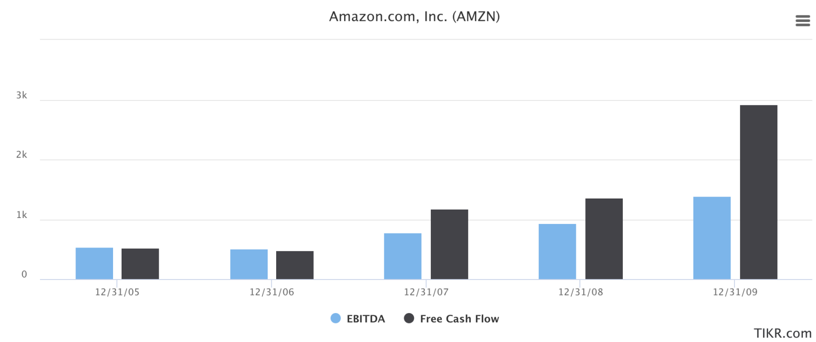
POWW hasn't generated a **single dollar** of positive free cash flow since it went public in 2018. This isn't a bad thing by itself. The trouble comes when EBITDA generation *far* outpaces FCF growth.

For example, POWW generated $54M in Adjusted EBITDA last year. Yet it *lost* $16M in FCF during the same time period.



It makes sense why POWW didn't buy back stock at these prices, because its 30% EBITDA yield isn't real. Bullshit accounting, as Munger likes to quip.

Compare POWW with AMZN during 05-09. Notice that AMZN grew *both* EBITDA and FCF at similar clips. That's a sign of a *healthy,* cash-flowing business.



Follow the cash flow. Follow the cash flow. Follow the cash flow.

I then asked Goodmanson about the mysterious disappearing 2M shares outstanding. Last quarter, POWW reported 116M outstanding shares. Its latest report showed 114M.

Accounting Discrepancies

Q: *"I noticed that last quarter you guys had 116M shares outstanding, and the latest 10K showed only 114M shares. Can you help explain the difference if it wasn't due to buybacks?"*

Goodmanson: *"You know I don't know the answer. I'll have to ask [Rob] Wiley [CFO]. These share counts sometimes change when certain shareholders exercise warrants and whatnot. We also had a few executives leave, which could change the share count. But I don't know."*

Comments

I wasn't sure if Goodmanson misspoke or if he simply didn't know how exercising warrants work. When a shareholder exercises her warrants, the company *issues* more shares to the shareholder.

If that were the case, POWW's share count should've *increased* during the year.

Again, another arrow in the "I don't think they know what they're doing" quill.

Ammo Manufacturing Profitability

***Q:** "I'm not convinced the ammo manufacturing business can generate cash as it grows long-term. Even if we assume specialty ammo (Streak) accounts for a greater percentage of sales, you generate 35% margins … I don't see how you can pull your key levers (SG&A, inventory, and A/R) hard enough to see unit profitability here. Am I wrong? And if so, where?"*

***Goodmanson:** "I think what you'll see is that our new manufacturing facility will allow us to scale and generate serious operating leverage. And you're right. We haven't sold a lot of Streak Ammo. But that's because we had to shut production down when we moved facilities.*

Once we get production ramping in the new facilities, you should see positive inflections in our unit economics.

***Q:** "Okay, that's fair. But do you think you'll be able to reduce the cash headwind from A/R and Inventory to generate profitable growth?"*

***Goodmanson:** "We've been capacity-constrained with trying to move into the new facility. Once we move into the new facility, you'll see a lot of changes in every lever we have … SG&A, margins, inventory, etc."*

Comments

I believe POWW's new manufacturing facility will provide operating leverage. However, I'm skeptical that the company can reach profitable growth in that business segment for one reason: Streak Ammo.

Specialty ammo is critical here, and it's our second **Lesson** from studying/investing in POWW.

Lesson #2: Beware of Vaporware

Is there merit to Goodmanson's explanation about why they haven't sold more Streak ammo? Yes. But consider that POWW generated **6% of its ammo revenue** from its proprietary Streak product.

In other words, 94% of its revenue came from a highly commoditized, low margin, low switching cost product.

Moreover, POWW would need to sell *a ton* of Streak ammunition to see an increase in total gross ammunition margins. Something it hasn't yet accomplished.

POWW's Streak ammunition was a critical piller in the original bull thesis. This differentiated product would enable POWW to generate higher margins than its competitors and, in return, outsized profits.

So far, this part of the thesis hasn't played out.

Accounts Receivable Issues

Q: *"I want to go back to two drivers of long-term profitability in the ammo business … Inventory and A/R. I'm more worried about A/R growth as it was nearly twice as large as your revenue growth. Why is that? What's been driving that?"*

Goodmanson: *"Look, we see continued strong demand for our product. Customers want more POWW products, and we haven't had issues with our distributors in selling to them. Some distributors pay early, and some pay late. Some we've had to put a credit hold on because they haven't paid on time. But we're at, what, $45M. I think it will hold there for a while."*

Comments

Goodmanson's answers didn't convince me. Nothing direct. Instead, he said some distributors pay on time, early, and late, which isn't breaking news.

Even if he *was* correct and consumer demand for POWW products is strong, why would A/R balloon 380% YoY?

The data doesn't align with what he said. We'll see if A/R surpasses the $45M mark, which Goodmanson thinks shouldn't happen in the coming quarters.

This brings me to my final Lesson from studying/investing in POWW.

Lesson #3: Trust, But Verify Revenue Growth

High revenue growth rates are excellent. It is one of the things we primarily scout in potential investments. But like the philosopher Ronald Reagan said, we must *verify* what we see on the top line.

We should always compare revenue growth against A/R growth. Remember, it's not that growing A/R is terrible. It's a normal thing for a growing business.

The issue comes when A/R grows at a *disproportionately faster* clip than revenues.

Had we done this, we could've spotted such potential problems in POWW sooner.

Gunbroker Improvements

Q: *"Gunbroker is driving all the profits here and is a much better business than the manufacturing side. How do you plan on improving Gunbroker and why do you keep investing resources in the worse, ammo business?"*

Goodmanson: *"Well, the first thing I'll say is that we're not going to need another 160K square foot manufacturing facility ever again. So we don't need to invest too much into* *manufacturing. However, we've been heavily focused on Gunbroker since the beginning of the year. And we think we're scratching the surface on what its capable of doing in terms of customer value, GMV and revenues.*

We've considered spinning Gunbroker off as its own publicly traded company!

Gun manufacturers want the data we have on Gunbroker. And we can give it to them, for a fee. Whether that's 50bps or 250bps. We're thinking of things like that. And look, there's still a lot of low hanging fruit. The former founder [Steve Urvan] isn't in the picture. He used Gunbroker as a personal ATM of sorts. He didn't build it with longevity in mind. So there's a good bit of tech debt.

We still see a clear path to doubling our take rate and our current GMV over the next few years."

Comments

Gunbroker is the better business, and Goodmanson knows this. You could hear the frustration when discussing Gunbroker versus the ammo manufacturing business.

Almost as if he *knows* POWW should scrap the commodity business, sell its assets, and double down on its online marketplace.

Even if they were to do that, the fact remains that nobody at the executive level knows how to run a marketplace business.

Goodmanson explained how he wanted the market to see POWW as an online marketplace business, not a commodity manufacturer.

But you can't expect the market to value you as a marketplace when you're spending $13M on a new manufacturing facility and can't articulate GMVs, ARPUs, LTVs, CACs, etc.

POWW *needs* a specific Gunbroker executive at the table and on conference calls. Goodmanson said he's taking a more active role in Gunbroker. I doubt he's the right fit, given zero prior marketplace experience.

Board Memberships

TITLE	COMPANY	TENURE
Board Member	Ammo Inc	05/2019–PRESENT
Board Member	Mix 1 Life Inc	04/2014–PRESENT

Career History

TITLE	COMPANY	TENURE
Founder	Maxwell Simon Inc	03/2021–PRESENT
President	Ammo Inc	03/2021–PRESENT
	Tealwood Asset Management Inc	01/2018–03/2021

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Education

DEGREE	INSTITUTION
BACHELOR'S DEGREE	Hamline University

A Potential Activist Candidate?

POWW is either a short or an activist target. The company has a good business in Gunbroker.com but will squander its value unless it hires a *great* marketplace operator.

I pitched POWW as an activist target to Connor Haley of Alta Fox Capital. We volleyed the idea around for a few minutes. But Connor passed (for now), citing potential regulatory issues with firearm sales and a general apprehension about owning an asset that facilitates gun/ammo transactions.

There is plenty of low-hanging fruit to improve Gunbroker's customer experience, take rates, GMV and profits over time. I'll continue pitching the idea to other activist investors.

You're paying ~14x EBIT for Gunbroker at today's market price while getting the manufacturing business for free. I think you'd see serious activist engagement if POWW ever traded <10x Gunbroker EBIT.

Concluding Thoughts

There are three key lessons I learned from studying and investing in POWW over the past few years:

- **Follow The Cash & Forget The Rest**
- **Beware of Vaporware**
- **Trust, But Verify Revenue Growth**

Like I mentioned earlier, it's not every day Mr. Market pays *you* to learn such lessons.

POWW has been a tremendous learning experience in investing in early-stage public companies. The best part about this game is that we can take the lessons we learned and *immediately apply them* to other ideas, like Desert Control (DSRT).

Portfolio Moves

Buys

- **BOUGHT** Clearpoint Neuro (CLPT)
- **BOUGHT** Teladoc (TDOC)
- **BOUGHT** Nerdy, Inc. (NRDY)
- **BOUGHT** Halliburton Jan 2024 $60 Calls
- **BOUGHT** Coupang (CPNG)
- **BOUGHT** Bitcoin (BTCUSD)

Sells

- **SOLD** Half of Tidewater (TDW) Long