

## Alternative Research Services, Inc.

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### RGR -- \$48.05

- Sell short
- The coming pop in the “Gun Bubble”...
- Backlog likely inflated
- Distributors could be forced to take delivery on canceled orders at retail
- SWHC reported: positive news already priced into RGR?
- Risk: Ammo shortage demand pull

Market Cap.	\$934 m
Shares Out.	19.5 m
Short Interest	4.6
Days short	12
Avg. Daily Vol.	387k
St. eps est. 2013	\$4.20
St. eps est. 2014	\$3.20
Px/book	8.3x
Px/sales	1.7x
Px/ EBITDA	6.4x

Source: Bloomberg

*“If no new bans are proposed manufacturers (such as Ruger) will catch up on back orders and the market will become saturated. This has in the past always lead to discounting as programmed orders are delivered to dealers who can’t cancel them but have to pay the bills. New buyers who purchased during the panic and paid higher prices (many of whom are in trying to sell their overpriced used guns to me now that the credit cards are due) will stop buying due to debt load.” – RGR Retailer Source*

For our second report, coming shortly, we will have more feedback from the channel. We are a little early but want to get you up to speed so that you are positioned properly when the timing improves. The timing will be right when the stock ceases to trade off the forward expectation from the backlog switching to current earnings per share. SWHC’s stock sold off after beating numbers, so we are less concerned about an upside surprise in RGR’s next quarter. We would use any rally from it as a short entry.

We looked at Sturm Ruger about a year ago as a possible short, thinking that the extraordinary growth in 2011 would not repeat itself in 2012. While we were in the process of writing our first report, our competitor, Off Wall Street, recommended the stock as a short. As is our pattern, when that happens on occasion, we backed off from publishing on the idea. First, there was a knee-jerk reaction that forced the share price down as the short interest grew dramatically, from 2M shares in 1Q12 to a peak of 9M shares in Dec. of 2012. However, they were squeezed out with Sandy Hook in December. Today, with the short interest back down below 5M, we are interested in the stock once again.

RGR’s revenue last quarter was \$155M vs. \$112M. Estimates for this year call for \$585M of revenue and \$3.95 of eps. However, it is 2014 eps expectations that grab our attention. The Street is at \$2.80. With the stock at \$49 and eps expected to be down 30%, the stock price should fall in 2014. We don’t want to wait that long. The conference calls have been bullish, and we know the stock is trading off the forward expectation from the backlog. Listening to management talking about demand and their desire to expand capacity is telling; however, we think backlog is already priced in.

In the back half of 2012 and into 1Q13, the consumer firearms industry experienced what some refer to as “the surge” – an unprecedented spike in consumer demand. In the wake of the unfortunate events in Aurora and Sandy Hook, there were several attempts by lawmakers to tighten regulation on consumer firearm purchases at both the federal and state levels. This set off a fear-based consumer buying spree, compounded by Obama’s re-

election, that effectively pulled forward purchase orders which otherwise would have been made later in FY13 or FY14. Production across the industry has been capacity-constrained, causing long delays in delivery to consumers. (We hear seven months or more for popular SKUs). RGR's order backlog steadily grew during "the surge," hitting an all-time high (both in dollars and units) in 1Q13. Although management repeatedly tries to discredit the use of backlog figures to estimate future sales, the backlog growth during "the surge" was egged on by increased promotions and incentive offers from RGR to consumers and retailers – greater than its competitors, according to some of our retailer sources. Meanwhile, management stated in its annual meeting a couple of months back that the longer delays in receiving product are really at the smaller, independent retailers – that the larger retailers are doing fine, and the discrepancy between the two is the fault of the distributors. We don't think that this explanation suffices in negating the coming "pop" in the "gun bubble."

While there has been a lot of talk about capacity expansion, some of RGR managements' comments, as well as the feedback we have received from firearms retailers, indicate that RGR is trying to manage their revenue by drawing out the window of time over which their (likely inflated) backlog is converted to sell-through. We think this is a dangerous game, since it ultimately hinges upon the assumption that consumers who pulled forward or increased their purchase orders during "the surge" will not cancel their orders, return/re-sell their received purchases, or simply buy something else instead of waiting around for RGR to deliver on their order. The fears that fueled "the surge" have waned in 2Q13, and both Federal background check ("NICS") data and our sources indicate that consumer demand is starting to take a nosedive. We think that we are in the late stages of a "gun bubble," and that much of the demand that was pulled forward to the previous three-quarters will evaporate as we move forward into FY14.

According to RGR's latest 10-K filing, RGR's distribution system is two-tiered. RGR sells its products directly to 14 wholesale distributors who service the domestic commercial market, with an additional 20 distributors servicing the domestic law enforcement market and two distributors servicing the Canadian market. These distributors "resell to federally licensed, independent retail firearms dealers who in turn resell to legally authorized end users." Revenue is recognized when a sale is made to these distributors – not the consumer/end-user. Consumer demand drives retailers' orders to distributors, which in turn drives distributors' orders to RGR. Management has given anecdotal evidence that distributors have been making oversized orders, in the hope of getting even a fraction of that order (e.g. having demand for \$25K in products, but telling RGR they need \$250K, expecting that RGR will refuse to fulfill 90% of the \$250K order due to production capacity constraints). The potential noose around RGR's neck is that they do not allow distributors to cancel orders – they must take delivery. This is in contrast to competitors like SWHC, who allow distributors to cancel orders.

As a side note, in the conference call transcripts, we noted what could be an antagonistic relationship between management and their distributors (see excerpts, below). Although dealer inventories are running dangerously low at present, if consumer demand continues to recede (as it has since May), and distributors must take delivery on their purchase orders, then there will be inventory stuck in the channel, a consequent drop and/or delay in distributor orders to RGR, and RGR's revenue growth will hit a wall, regardless of production capacity issues.

SWHC reported after the close on Tuesday, June 25th. Despite delivering inline EPS, beating revenue estimates, and providing strong guidance that outstripped both top and bottom-line consensus estimates for both 1Q14 and FY14, the stock was flat in after-hours trading, before dropping as much as 4% on Wednesday, with RGR down almost 3% on the same day. We consider this to be market confirmation that the positive news is in the stock price, and that there is plenty of money to be made shorting the "gun bubble," IF we can get the timing right.

Finally, another issue that may help the short thesis is that ammunition has also become scarce. To paraphrase one of the articles we came across in our research: buying a gun when bullets aren't available is like buying a car when you can't buy gas.

## RGR Orders, Backlog, Estimated Sell-Through

	1Q13	4Q12	3Q12	2Q12	1Q12	4Q11	3Q11	2Q11	1Q11
Units Ordered by Distributors (000's)	1,067.5	1,069.2	318.3	291.5	1,200.1	452.3	168.7	263.5	503.5
Units Shipped to Distributors (000's)	502.3	467.3	425.5	421.1	382.5	315.1	276.5	279.6	251.8
Units on Backorder (000's)	2,090.2	1,507.2	908.7	1,016.7	1,153.5	337.4	204.5	315.5	332.7
Estimated Units Sold from Distributors to Retailers (000's)	514.2	504.7	396.9	410.3	460.8	291.8	244.7	264.4	284.3
YoY Change (%)									
Units Ordered by Distributors (000's)	-11%	136%	89%	11%	138%	87%	8%	90%	65%
Units Shipped to Distributors (000's)	31%	48%	54%	51%	52%	33%	35%	24%	6%
Units on Backorder (000's)	81%	347%	344%	222%	247%	216%	105%	113%	39%
Estimated Units Sold from Distributors to Retailers (000's)	12%	73%	62%	55%	62%	24%	23%	24%	12%

### Survey of RGR Retailers

We sent out an initial email survey to 800+ retailers listed on RGR's website, comprising almost all listed retailers in the eastern half of the U.S.<sup>1</sup> Over 20 retailers replied to us, of which a dozen provided meaningful information. We have provided these retailers' comments below. A few respondents were more bullish on RGR than the majority; we have included their comments near the end of this section.

Retailer #1: "We're expecting a diminution in sales since so much of the last five months' sales have been accelerated consumption; i.e. planned purchases undertaken early, before an expected limitation on supply."  
 "We expect that Sturm, Ruger's backlog is going to affect their sales more than other manufacturers. Beginning late last year, Sturm, Ruger offered several incentive programs to dealers that we don't see the company repeating - at least, not successfully - in the short term (5 years). Few manufacturers offered such incentive programs to dealers, so most have residual demand that we expect Sturm, Ruger has already exhausted."

"Sturm, Ruger offered several programs of the 'Order 10 fighter-bombers and get an attack helicopter FREE!' type, each featuring different models. Naturally, large retailers (chains and Internet retailers) benefitted more, being able to order single SKUs by the pallet - thus contributing to manufacturing backlog - in contrast to smaller retailers, tied to wholesalers."  
 "Whereas other manufacturers may only see a 10-15% drop in sales, this year, we reckon that Sturm, Ruger could see a greater effective drop; i.e. sales that result in delivery, rather than another backlogged order."

"Since the ten fighter-bombers could be ordered for dated delivery (rather than all at once), we were able to sign up for programs with three different wholesalers - but we only received four items in total from all three sources

<sup>1</sup> The response from these survey recipients was meaningful enough that we paused to digest and report it before moving on to RGR retailers in the Western U.S. We will survey RGR retailers in the western half of the U.S. as our research continues, in future reports.

- and now the programs have ended. Yes, we will receive all program items - eventually. This will decrease our near-term orders of additional Ruger product from any wholesaler. In effect, we have already ordered all of our Rugers for 2013 and 2014 - perhaps 2015.”“We can’t help imagining other Ruger dealers are in the same situation, to one extent or another. We are all fortunate in that no other manufacturers have painted themselves into this sort of corner.”

Retailer #2: “Yes, it’s slowing down. They are all making too many models, so there are always shortages. The rush is over for sure, except for ammo.”

“I could bore you to tears about this. Smith and Wesson are even worse in my opinion. They haven’t shipped any of their best selling revolvers in large numbers in months. Every gun company has too many items right now. I think they do it to drive demand because they will always have shortages. They also don’t want to catch up, because when things slow they don’t want to have extra inventory sitting around. Gun shops are suffering in two ways right now. Ammo shortages and merchandise shortages. Both groups waste time with so many variations of the same product that it is maddening. Like going to the grocery store to get ranch salad dressing. There are about 20 choices of ranch per brand. It’s the same with ammo and gun models. Distributor exclusives make it worse.”

Retailer #3: “We are getting killed due to the lack of ammunition, Sturm Ruger would do well to go into the ammo manufacturer side. As a reputable company, Ruger quality would hold sway over many of the new manufacturers that have recently arrived. The main problem; there is but one primary powder manufacture. So developing a second source of powder would firmly place Ruger at the industry forefront with the result leaving the major firearms manufacturers ‘like a deer caught in the headlights.’ Our gun range sales have dropped 70% over the last two months; customers do not buy firearms they cannot get ammo for. Individuals will not engage in recreational shooting if they do not have a ready supply, more important they will not shoot for recreation when faced with serious issues that compromise their moral values. They pray and keep their powder dry. Secondly, the firearm industry as a whole has saturated the market on the ‘assault rifle side,’ the ‘concealable defense handgun’ is the strongest trend we see, and our store is NOT being resupplied from our distributors due to LACK OF INVENTORY. We have been out of Ruger LCRs for six months, and I have over 20 customers waiting for that particular firearm, for a small retail store such as ours that is very frustrating.”<sup>2</sup>

Retailer #4: “There is already a huge slowdown in sales in firearm related products. A lot of dealers were prepared for a high demand end of the year sales run. But this was the perfect storm 1. re-election of President Obama, 2. Christmas demand, 3. Sandy Hook, 4. the end of world 2012 people, 5. All the cable gun related shows glamorizing firearms, 6. Tax refunds. Demand was through the roof, product unavailable; normal rational people got caught up in a panic, and they paid dearly for it. Double, Triple Retail was everywhere, and people lined up still Gun Bubble. I told everyone to no avail what was happening, but they were scared of what might happen. We even bought SWHC stock and told people to do the same, buy the rumor, sell the news. Earnings this Quarter will be great, but there is no way it can be sustained, Yes there is still some back orders from dealers as there is every year when its dealer stocking program time. The problem now will be a glut of used firearms and related products flooding the market from the folks who panicked, overbought and overpaid. We already see it, Now lots of product, little demand, and smaller margins.” [This was written before SWHC reported.]

Retailer #5: “The Obama Administration has been America’s best gun salesman. Pure fear of our Government has pushed sales late 2012 in 2013. Ruger is a leading Firearms retailer with many new ideas from year to year. This is what drives the stock up, shortage of product.”

“In 2013, we spent \$350,000 on Ruger products, and to date, have received less than \$100,000 Many people got tired of waiting and bought other firearms, or spent the money on personal items.”

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<sup>2</sup> We don’t overstate it but if there was a sudden surge in ammo supplies it could spawn further gun sales. It’s a risk worth identifying even though we can’t quantify it, yet.

“I foresee 2014 to be strong, but not near the pre-sold units in 2013. Ruger has programs aimed at dealers to buy early in December, to be delivered in the following year. This is what led to the huge back order (almost inflated ) sales.”

Retailer #6: “Your crystal ball is probably as good or better than mine in predicting gun sales. Been at it for 21 years and Ruger had a record-breaking year so far along with many other gun manufacturers. “

“Gun sales are driven by fear of new regulations banning or restricting them. If V8 car engines were going to be banned everyone would run out and buy one. Gun sales (and demand regarding phone queries and emails) have dropped off severely starting in mid-May or so. I don’t see them picking up anytime soon (except for a few new and hard-to-find models) UNLESS they start talking about banning them again.”“Generally speaking, the people who were into guns already had them before this last panic started in late December (after Sandy Hook). What happened was a whole new crop of people (who may have been thinking about getting a self-defense gun - nobody rushed out to buy a deer hunting gun) started buying when it looked like significant bans were going to be put in place.”

“What will happen for the rest of this year and in 2014 is entirely dependent on what legislation is brought up on the national or state level. If there is another tragedy (such as Sandy Hook) that the anti-gunners can exploit then new laws (now waiting in the wings) will be proposed and that could well lead to another round of panic buying. Without such a ban I think sales will drop significantly from year-to-date levels to 2012 levels or below for 2014.”

Retailer #7: “Sales are slowing down, but we still need a lot of guns we have not been able to get for around seven months. I have a need for about 200 revolvers we need from both and 100 pistols...”

Retailer #8: “If they will make the right product that is needed will take many more months to catch up. Same problem with S&W there are guns we need, and they just have not been making them. The stuff they make all the time we are caught up on.”

Retailer #9: “I am a retailer in a major metropolitan area, and my feeling is that the gun market is going to wane somewhat particularly following the large push resulting from the Conn. Incident. I felt that consumers who anticipated buying in late 2012 and 2013 were motivated to buy earlier. I do not feel it is specific to Ruger but rather to the market in general. It is too soon to determine how the rest of the year will be and any predictions will only be guesses based on foot traffic in the store and some phone calls.

Retailer #10: “It is not just Ruger. S&W, Springfield, just to name a couple. Plus most of the companies making ars.”

Retailer #11: “The overall insanity in the industry is not what caused the spike in Ruger stock. It might be one of the factors, but there are several more....[w]hile you say they are 1.5 million units behind, I believe the backlog would be much greater if they hadn’t flat out refused orders, ‘unreasonable orders’ as they called them.”

“If no new bans are proposed manufacturers (such as Ruger) will catch up on back orders and the market will become saturated. This has in the past always lead to discounting as programmed orders are delivered to dealers who can’t cancel them but have to pay the bills. New buyers who purchased during the panic and paid higher prices (many of whom are in trying to sell their overpriced used guns to me now that the credit cards are due) will stop buying due to debt load. Of course, all bets are off if politicians start talking about another round of gun bans (like Obama said this was just round one).”

Retailer #12: “One man’s opinion. When I can’t get a quote on the delivery of a gun anytime in 2013 and am placing orders for ‘sometime in 2014’, I have trouble predicting any return to ‘normal.’ The entire industry has a problem on top of that which could benefit Ruger, viz: products are announced a full year or more before they are available without paying bribes and black-market prices. Ruger is rarely at fault; when they can’t deliver, it

seems that they simply underestimated demand. If they continue to introduce new products with realistic delivery schedules, they will generate revenue and earn goodwill that most of the industry does not deserve.”“One more comment. Demand is being held back by distributor practices: charging black-market prices and withholding product from small dealers, and selling directly to customers. For example, I can get ammunition, but my customers balk at what I need to charge to get a lousy 20% margin, or badmouth my business if they do pay.”

### **RGR Annual Meeting (Day After 1Q13 Earnings Release)**

“...a part of the underlying story here is that as we went into the distributor shows what we found was that the retailers were ordering extraordinary amounts. You might have a retailer say with a \$25,000 credit line going into the distributor show and trying to place an order for a quarter of million dollars. It was an order he was never going to get, an order he couldn't afford, and nor could any of the factories ever produce enough to fulfill them, but he had -- he placed that order at Ellett Brothers. And then he placed that order at AcuSport. And then he placed that same order at Big Rock. And then he called up Bill Hicks and placed the same order. So he was hoping that maybe he'd get 1% of what he ordered, but that's a crazy way to run the business. And he'd be in real trouble if he started to get some of what he ordered.”“So we told the distributors that we weren't going to accept ridiculous orders from them. We, in fact, went through our promotions, like for example one of the spring promotions was a buy 10, 1022s and get one free. And we looked at our production capacity, and we determined how many of those promotions we could fulfill. And we figured out what the allocation would be for each distributor. And we called them up, and we told them: 'Distributor X, you're going to get 100 1022 promotions, and that's it. And you need to call your retailers, and you need to tell them that. You need to tell them who is getting them, how many they're getting, and who is not getting them so they can manage their business.' And we pushed that down the food chain as best we could.”

“So we limited the incoming orders here, so consequently we had a decline in incoming orders in the first quarter, but the backlog is still two million units on order, which is a pretty heady number when you consider a year ago we were just trying to be the first company ever to do one million, okay?”

“The distributors frankly ought to be in the six to eight range on inventory turns, meaning that hot new products are probably turning higher than that, but that the mature products they've always got at least a couple of months on hand inventory. And instead, they're at 35 inventory turns. So that's something that we're going to be working hard on when things calm a little bit, or our production catches up. And we're going to work hard on getting these guys to get that inventory turns to a more reasonable rate reflecting their role as a wholesale distributor.”

<Q>: “My local dealer, who is a small dealer, has had three LCRs on order since December. And I can't even get an LC9 from him. Can you shed any light on that?”

<A>: “If you are a big retailer, you're making money hand over fist these days. If you are a small retailer, you're probably at great risk of going bankrupt. It's very sad, but we're [tiered] two-step distribution. We sell all of our firearms to wholesale distributors. They, in turn, allocate those products out to whatever retailer they want to sell them to. And by and large they take the easy road, and they sell them to the biggest retailers, the biggest independents, and somewhat to the chains. And they pretty much ignore the little retailers....[i]t's very unfortunate, but if you've ever had dreams of opening a gun shop, this is exactly the wrong time to do it. Don't even try because little retailers are struggling and it's sad.”

### **RGR 4Q12 EPS Call**

“The Company's finished goods inventory decreased slightly in 2012. Our efforts to rebuild safety stock have again been outstripped by increased demand. Despite the increased shipments, our distributors' inventories also decreased by 76,000 units in 2012. We believe that both Ruger and the independent wholesale distributors would benefit by having more of finished goods inventory to allow for the rapid fulfillment of demand. Our observation of retailers and anecdotal reports from industry sources also indicate that the retailer shelves have

less than normal amounts of inventory. Our goal is to replenish our finished goods inventory in future periods to levels that would better serve our customers. This replenishment, which could increase the value of finished goods inventory by as much as \$15 million from the current level, is not likely to occur until retail demand for our products slows down.”“In 2012 bookings were more than double 2011 bookings, and our backlog totaled 1.5 million units at December 31, 2012. Nonetheless, we do not use backlog as a key indicator when planning and operating the Company’s business. Instead, we focus on estimated sell-through of our products from the independent wholesale distributors to the retailers to run our business.”

<Q>: “Okay. And then just a second question regarding the orders that you took here recently, obviously, everyone is short on inventory right now. At this point last year, I think you guys stopped taking orders in the spring because you thought that -- you didn’t think you were going to be able to make them or whatever, but you just seemed to have taken a lot more orders this year. And I’m just curious why maybe you didn’t stop taking orders or how you are thinking about that backlog playing out?”

<A>: “I believe the question is, if I cut off orders after 1 million units last year, why didn’t I do it this year? And the reason I didn’t do it this year is that simply people didn’t understand what we were doing last year. People misinterpreted that we stopped taking orders from the wholesalers and assume that we stopped production. In fact, our press release on the matter was extremely clear, but I was shocked at the number of people who couldn’t read plain English and got confused about what we did. So I’m not doing it again.”

<Q>: “You’ve talked, Mike, in the past, backlog discipline and you wanted to make sure that you didn’t get over ordering in that. With the, again, the tremendous civilian arsenal buildup, what do you guys see, and what is your sense of order bookings and the discipline, or is that pretty strong and decent on a sell-through?”

<A>: “I think the discipline from the retail level placing orders on wholesalers is nonexistent. I mean what I observed at some of the distributor shows is you might have a guy with a \$25,000 credit line ordering \$250,000 worth of goods, frankly, hoping he can get to \$25,000, but still placing truly absurd orders. I believe I heard anecdotally that a couple of the distributors at their shows booked more than \$1 billion, which they are just way, way in excess of anything they’ve ever booked before, way in excess of any annual volume they’ve ever enjoyed, and completely unrealistic in terms of the industry being able to increase capacity to supply that kind of numbers. So the retailers, by and large, ordered amounts way more than what they expect to get. And then in some cases, but not all, in some cases, the wholesalers reacted enthusiastically and placed large orders on us. But I think everybody sort of implicitly understands that it’s not all going to happen.”

<Q>: “Mike, as I recall, your back orders from wholesalers are not cancelable per Company policy.”

<A>: “That is correct, and we have been reminding them of that.”

<Q>: “So would the Company adhere to that policy regardless if demand, for example, were to slow sooner and possibly more sharply than everyone might have thought with the plan to hold your wholesalers to that?”

<A>: “Jim, if there are any wholesalers listening, the answer is absolute. If the wholesalers aren’t on the phone, the answer is we’ll use common sense as we did back in I think it was the late 2009 or spring of 2010 when we canceled some of the Mini-14 orders that just were ridiculous. So we’re trying to enforce the discipline and encourage the discipline, but at the end of the day, unfortunately, the distributors know that we are going to act responsibly, and we’re not going to stuff the channel.”

<Q>: “Now, on a related point, speaking of sell-through, how many weeks supply on the part of your distributors is sufficient, in your view, to service your retail customers adequately with good fill rates on your products?”

<A>: “I’d, frankly, like to see them act like wholesalers and have at least eight weeks on hand. But by and large, these days they are acting more like order brokers, and I think they are cross-stocking all the inventory they receive from us. I don’t think that goes in their warehouse.”

<Q>: “Okay. You talked a little bit about building up, Mike, your safety stock. Pretty tough in this market with the demand. Are there any incremental specific pistols, revolvers, that you might be able to, or is everything really at capacity?”

<A>: “Okay. Talking about inventory, the issue is, how much should we have? And clearly it’s a lot more than we have had, and I believe that applies to our wholesale distributors, as well. For example, had we all had an uncomfortably high level of inventory going into this winter, we would have sold all of it and then more. But we didn’t. And so all we could sell was what we could make each week. And the people who have been in the industry over the decades have told me over and over again that you ought to have a lot more than you think. Because, unfortunately, there are incidents like Newtown or other ones or like Obama getting elected that create great political drive behind demand, and we clearly had almost no inventory at all and so really couldn’t respond by emptying the warehouse. There wasn’t anything in there to start with. The wholesalers did have a little bit. And as you saw, their inventory went down 70,000 and some units, which was a huge percentage of their overall inventory. Shame on them -- they should’ve had much more in inventory to take advantage of political opportunities. So I think your question was, can we shortly increase inventories? And the answer is not until demand slows down. And we have been since I said like November, December of 2010, we have been selling every single thing we make, and it is flowing through the wholesalers to the retailers at about the same pace.”

### **SWHC 4Q & FY13 EPS Call (June 25th, 2013)**

<Q>: “Could you maybe talk about your assumptions for ‘14 as it applies to what you expect for the industry to do? Obviously, you have a pretty good picture with your backlog, where things stand right now with the NICS data. But just give us an idea of high-level what you guys are thinking as far as NICS and industry growth as the year progresses.”

<A>: “Really, we went back to what the growth rate that we’ve discussed before using history, which is around 11%, around 10% or 11% every year. As we all know, we’re coming out of a surge period. There was no doubt some buy-forward there by the consumer. We’ve worked hard understanding that. We’ve done a lot of analysis about that. So factoring that alongside historical growth rates where we are, gives us a, let’s say, a good understanding of how we see the market going forward. And really in answer to your question, I can come back to using those more average historical growth rates. It’s a good number for you.”

<Q>: “And given the seasonality, shouldn’t we expect the backlog to decrease in Q1?”

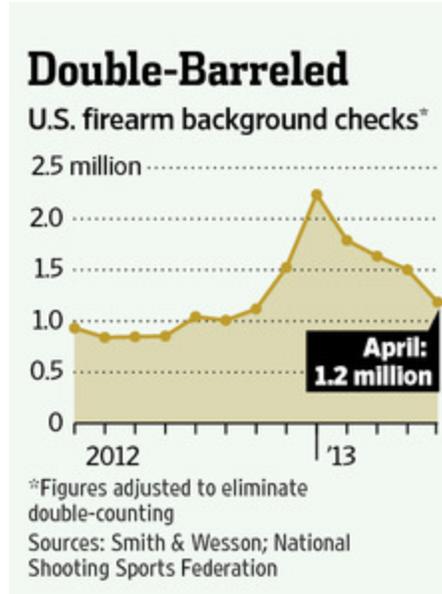
<A>: “...in terms of how we think about the backlog, as you’ve heard me say before, we don’t take it to the bank. It can be canceled for sure. We use it as a data point. Sometimes I think it’s a metric or a number too closely looked at by certain individuals. I have to say that we are looking at a new way of thinking about our backlog, and that’s really another step in our strategy just to simplify our business and continue to make us even more of a marketing is driven company because in all the other consumer businesses I’ve worked, and I’m not used to working with this huge backlog company. So as I say, we’re working on a new way of accessing and managing our backlog with customers. But hopefully, we’ll eliminate some of the noise and make it a much more meaningful number for managing the business. But we’re only going to report it annually. You’ll find it in our 10-K each year.”

<Q>: “Okay. And you mentioned that the industry typically is growing 10%, 11% per year, and you’re forecasting 12% revenue growth for 2014. But you guys are taking market share on top of that. So would you say that you’re conservative for 2014?”

<A>: “...the 10% or 11% is the historical average. We did see that after the last surge in ‘08, ‘09, that it did drop the following year to sort of a flat number. So if you -- obviously, what the market’s going to do is anybody’s guess...”

## News Articles, Analysis

WSJ's "AHEAD OF THE TAPE" - June 24, 2013, 5:15 p.m. ET – Smith & Wesson's Owners Target Value<sup>3</sup> - By SPENCER JAKAB – "Controversial as the topic of gun ownership is, owning stocks of gun makers is also a touchy subject. Pension funds and institutional investors came under intense pressure to dump stakes in firearms makers following last December's mass shooting in Newtown, Conn. Others already had shunned the sector, along with tobacco, booze, and casinos, on ethical grounds."



"Gun enthusiasts already were in a buying mood after the re-election of President Obama. The number of U.S. firearm permits from last November through this January, adjusted for double-counting, rose 29% from a year earlier, according to the National Shooting Sports Foundation...[t]o the extent that gun owners purchased firearms in anticipation of regulations, they pulled forward future demand..."

**Ammo Shortage Hits Shooters, Retailers<sup>4</sup>** - "Hoarders and online sellers are driving prices up as availability shrinks" – Tuesday, February 26, 2013, 10:12 pm – SULLIVAN – "It's the form of gun control that few people saw coming. No ammo. At least, certain types of ammunition have become extremely hard to find and very expensive when it surfaces. The hunt for 9mm, .22-caliber, .380 and a few other popular bullets intensified after the Obama administration resurrected the gun control debate following the November election and Sandy Hook Elementary massacre in December."

"The shortage has become so pronounced that many retailers are limiting per-customer sales because of hoarding. Local Wal-Mart stores – including store #65 in Sullivan – limit sales to three boxes per person. Ditto that policy at Dick's Sporting Goods in West County Center. Workers at both say that people are constantly calling or cruising the ammunition shelves in desperate search for a product. It's not all types of ammo that's in short supply – shotgun shells and some calibers are readily available."

"'We can't keep certain ammo stocked, and we don't get as much delivered as we normally do,' said an employee at Orscheln's in Sullivan. It's the same situation for gun dealers, gun ranges, and people that normally have wholesale or inside access to ammo. Last week at Ruby's Guns in Ellisville – formerly of Sullivan – a revolving door of customers inquired about ammo. Owner Steve Walsh could only shake his head – like everyone else in the business – and wait it out."

<sup>3</sup> <http://online.wsj.com/article/SB10001424127887323998604578565740555164734.html>

<sup>4</sup> [http://www.sullivanjournal.com/features/article\\_a85369de-8093-11e2-98c7-001a4bcf6878.html](http://www.sullivanjournal.com/features/article_a85369de-8093-11e2-98c7-001a4bcf6878.html)

“Sales associates at area Wal-Mart stores have plenty of stories about the shortage. Shoppers that don’t own or shoot guns are hoarding the hot commodity, turning a profit by selling ammo online. A common box of .22 shells will sell for two to three times the normal retail price. And for the person holding a supply of 9mm – name the price. More than a few area shooting enthusiasts say some privately owned ammo retailers are pulling the product off the shelves for the lucrative online market.”

“Rollanet, Craigslist, and other free online classifieds sites are posting offers that would have been unheard of just a few months ago. Although not the first ammo shortage to hit the U.S. in modern times, it is believed to be one of the toughest. But what is driving the shortage? The facts are few, but conspiracy theories abound.”

“Whether those seeking ammunition are shooters, hunters, or speculative hoarders of high demand/low supply commodities, the reality is that the supply of popular ammo is critically short – or often nonexistent. Even those with the ability to load their ammo, primers are also becoming impossible to find.”“There’s a quick and easy way to get gun control,’ said a local gun expert, who asked to remain unnamed. ‘Take away the ammo.’”

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