Sturm, Ruger & Co. Inc.

NYSE:RGR

Analyst: Lionel Krupka
Sector: Defense Primes

BUY

Price Target: $68.50

Key Statistics as of 04/29/2016

Market Price:	$64.03
Industry:	Firearms manufacturer
Market Cap:	$1,214.2M
52-Week Range:	$48.10-78.09
Beta:	0.47

Thesis Points:

- Political and security environment is favorable to Ruger's financial performance for the coming year.
- Large amount of cash on hand and no debt guarantee freedom of action for future investments, stock repurchase programs or special dividends.
- Ability to decrease operating costs in the future while increasing revenue.

Company Description:

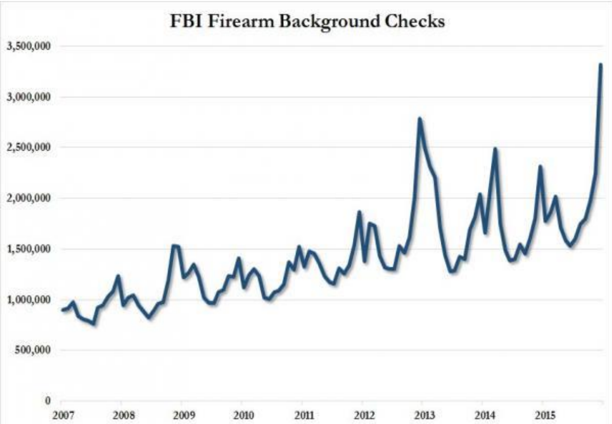
Sturm, Ruger & Co. Inc. (Ruger) is company with a 67 years history. It was founded in 1949 by Alexander Sturm and William Ruger with a $50,000 capital. Since its humble start in Connecticut, the company has grown and become one of the major players of the firearms manufacturing industry. It went public in 1969 and started to be traded on the New York Stock Exchange in 1990. Its leading position in the market today has not altered the quality of its products and its brand image. Ruger remains the only firearms manufacturer that have all of its production facilities still located in the United States. It operates in two different segments: firearms manufacturing and casting. Most of the revenues come from three different lines of firearm products: rifles (single-shot, autoloading, bolt-action, modern sporting categories), pistols (rimfire and centerfire autoloading) and single or double-action revolvers and accessories.

Thesis

Ruger is the last firearm producers in the U.S that kept all its production and selling apparels within the country. Among one of the best recognized brand in the firearms industry today, Sturm, Ruger & Co has been able to create and distribute new appealing products to both domestic and international markets over years. The presidential election in the last quarter of 2015 as well as the recent terrorist attacks also signal that demand for firearms is most likely to increase in 2016. In addition, the company forecasts to decrease its capital expenditures in 2016, and it has a proven record of higher value creation than its competitors with an historical ROIC/WACC ratio three times higher. The management, led by a CEO with military experience, has driven the growth of the company without taking any debts. No debts and the current high level of cash on hands is also an assurance of future flexibility regarding changes in the market environment. Management could also decide to reward shareholders with a special dividend or a stock repurchase program.

Macro Environment

According to the National Rifle Association, there are approximately 300 million privately owned firearms in the U.S, and this number increases on average by 10 million annually. The National Instant Background Check System (NICS), managed by the FBI, is considered as the most reliable proxy for monthly firearm sales. In 2015, the FBI processed an all-time record of 23 million checks.



Since 1998, two of the highest weeks for NICS checks were in January and February 2016, respectively ranked 9th and 7th. Background checks have increased by 25% in March 2016, compared with 2015 figures. It was the 5th highest monthly record since NICS' inception, leading the industry to a potential new record this year.

The growing American interest for gun purchases have been mainly driven by recent terrorist attacks in Paris in November and San Bernardino in December. Obama's administration will to expand background checks and gun control in general have also been key drivers for firearms sales expansion. This upward trend is not likely going to struggle by the end of the year. According to Real Clear Politics, polls show that the future democrat candidate has the most chances to win the presidential race. Both Hillary Clinton and Bernie Sanders are in favor of broader gun control policies. If consumers expect new regulations limiting access to firearms, they are going to stock up products, hence increasing future expected revenues for firearms manufacturers.

People

The executive officers of the company are all experienced professionals and very enthusiast about their business. The Chief Operating Officer, Christopher J. Killoy, has a military background. He graduated from the U.S Military Academy in 1981, and worked for Stinger System Inc, a manufacturer of non-lethal weapons for the law enforcement. Michael O. Fifer, the Chief Executive Officer, graduated from the Naval Academy in 1978 and served as a Submarine officer. He previously worked for Watts Water Technologies Inc., where he was able to turn inefficient business units into profitable divisions. Under is management, Ruger's stock has risen from $7 to $65, which is an increase of 779% in 10 years. Today, Ruger employs 1920 people across the U.S, and it has achieved to develop high commitment from its employees. For instance, there is no turnover among the engineering staff that counts 140 employees, hence creating value through designing and manufacturing expertise.

Operations

Historically, Ruger firearms sales have represented 99% of the revenue, and the casting activity has accounted for the remaining 1%. Ruger biggest advantage lies in its distribution channels. Even if it still sells directly to end customers, the company has achieved to limit costs and gain in efficiency by selecting a network of twenty independent and federally licensed wholesalers who resell the entire line of products to independent retailers for the commercial market, twenty four for the law enforcement market and two for the Canadian market. The five largest customers have accounted for 57% of total sales in the last three years, which has allowed Ruger to limit the number of employee dedicated to customer service to fifteen.

Regarding production, the company has at its disposal four manufacturing facilities: Newport, New Hampshire (350,000 square feet owned), Prescott, Arizona (230,000 square feet leased), Mayodan, North Carolina (220,000 square feet owned, not fully operational) and Earth City, Missouri (35,000 square feet leased). Three other non-production facilities exists in Southport and Enfield (Connecticut) and one building of the Newport plant. Ruger does not have any debt related expenses regarding its owned facilities, enhancing the ability of the company to adapt to new market environment if necessary.

Porter's Five Forces

Bargaining power of suppliers: LOW

Even though Ruger does not have a much diversified distribution channel, the bargaining power of suppliers is low. There are many different suppliers for steel, walnut, birch, beech, ceramic material, maple and laminated lumber, metal alloys and other raw materials that are needed for the manufacturing operations of the company. There are also no signs that these raw materials could experience shortage within the investment horizon considered.

Bargaining power of customers: HIGH

The bargaining power of customers is relatively high for Ruger. Despite the fact that Ruger enjoys a good brand recognition, there are a lot of competitors in the marketplace today. Buyer choice is not limited because of this competition. In addition, the five largest customers, which are also distributors for the entire Ruger's line of products, represent a total of 57% of the revenues. Therefore, Ruger has a high dependency on its distributors.

Threat of substitutes: LOW

Ruger manufactures rifles, pistols, revolvers and various accessories related to firearms. There are no existing substitutes for firearms. One could think about the non-lethal weapons market as possible substitute for firearms, but it is not very diversified and does not respond to the same needs. Ruger is firstly targeting hunters, sportsmen, people interested in self-defense, law enforcement forces and government agencies. Ruger is also sitting on a designing and manufacturing experience of 67 years, which make its products unique for customers.

Existing rivalry: HIGH

The existing rivalry factor is high for Ruger. There are many other well-known firearm manufacturers present in the American market today. Smith & Wesson Holding Corporation, Vista Outdoor Incorporation or Taser International are possible companies that customers could prefer to Ruger when they consider buying weapons.

Barriers to Entry: HIGH

There are very high barriers to entry the firearms manufacturing industry. Production facilities, manufacturing and designing expertise, technology and brand recognition would not be easy to obtain for any new competitor. In addition, a new competitor will have tremendous difficulties against existing companies that have managed to use economies of scale as critical factor to success.

Financials

Sturm, Ruger & Co is evolving in a very competitive market. Since product differentiation is difficult to achieve in the firearms industry, brand recognition is a predominant aspect in Ruger's strategy as well as managing value creation, efficiency and margins.

ROC /WACC			ROIC W/O GW		
	History	*LFY*		*History*	*LFY*
RGR	6.16	3.43	RGR	57.8%	30.9%
Competitors	1.87	1.60	Competitors	45.0%	17%
ROIC			**WACC**		
	History	*LFY*		*History*	*LFY*
RGR	57.8%	30.9%	RGR	9.0%	9.0%
Competitors	35.5%	10.4%	Competitors	15.2%	6.5%
Capital Usage			**EBITA Margin**		
	History	*LFY*		*History*	*LFY*
RGR	5.30	3.0	RGR	19.2%	17.2%
Competitors	4.19	2.0	Competitors	11.4%	14.0%
Unlevered Beta			**COR/Revenue**		
	History	*LFY*		*History*	*LFY*
RGR	0.33	0.87	RGR	65.8%	68.8%
Competitors	0.84	0.52	Competitors	70.1%	72.4%

Table 1: Ruger - Industry comparison

Table 1 shows that Ruger outperforms its main competitors in the firearms production, Smith & Wesson (SWHC) and Vista Outdoors (VSTO), on a lot of different levels. Value creation is more important for

Ruger with a ROIC to WACC ratio of 6.16 historically compared with industry's 1.87. In the last fiscal year, the company created as much as twice more value than its competitors. WACC has stayed at 9.0% mainly because Ruger has achieved its growth without taking any debt. In addition, Ruger's engineers and designers have been able to create new products on short cycle of one to three years. These new products – less than two years old - have driven growth and represented $115.4 million (21%) of 2015 sales and $89.4 million (16%) in 2014. Consequently, EBITA is at 19.2% historically and 17.2% in the last fiscal year, against 11.4% and 14.0% for SWHC and VSTO. Inventory level decreased by 16,800 units from 430,900 in 2014 to 358,400 in 2015, driven by a strong demand in 2015 fourth quarter. The strong demand drove shortage for particular new products, such as the Precision Rifle. The company is deploying strong efforts to ensure that wholesalers and retailers keep more products in their inventories during the summer to avoid any inconvenience to customers. As a result and because of the political and security environment, it is reasonable to expect further growth in revenues in the coming year. Ruger's revenues increased by 1.2% in 2015 while Smith & Wesson's decreased by 11.9%. Historically, Sturm, Ruger & Co has also beaten revenue expectations by 5.93% and adjusted earnings per share consensus by 36.21%.

Moreover, Ruger is more efficient when it comes to capital management. Its capital usage ratio (revenues/invested capital without goodwill) was at 3.0 in the last fiscal year and at 5.30 historically compared to 2.0 and 4.19 for competitors. The cost of goods sold to revenue is also better on both horizons.

FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015
5.27	5.16	4.74	4.24	3.47	3.51

General & Administrative expenses to Revenues ratio

As the table above shows, Ruger has achieved to reduce its general and administrative expenses over the years. We can observe a slight increase in 2015 that is due to a new summer marketing campaign that did not exist before. At the same time, the management planned to decrease capital expenditures from their 2015 level at $28.7 million to $25 million in 2016. For the valuation process, all these elements lead to adjust operating expenses to revenues forecast in the continuing period to analyst forecasts at 71%.

Furthermore, Ruger is historically less risky than its competitors with a 5-year unlevered beta of 0.33 against 0.84 for the industry. It also have a lot of cash on hand with 69.2 million available at the end of 2015 compared to 42.2 million for Smith & Wesson, allowing management to enjoy freedom of action regarding the future of the company. It could easily decide to invest in new facilities or research and development, to repurchase shares or to provide shareholders with a special dividend.

FY 2010 12/31/2010	FY 2011 12/31/2011	FY 2012 12/31/2012	FY 2013 12/31/2013	FY 2014 12/31/2014	FY 2015 12/31/2015	CAGR
5.17	10.74	12.18	9.46	1.84	15.22	24.10%

Free Cash Flow Margin

The compound annual growth rate of free cash flow margin, at 24.10% over the last five years, proves the financial efficiency of the company.

Finally, unless Smith & Wesson and Vista Outdoors, Ruger distributes dividends and has a clear policy about them. It redistributes approximately 40% of the net income to shareholders every quarters for a twelve months dividend yield of 1.90%, and a five years dividend growth of 31.87%.

Conclusion

According to a Gallup poll released in last December, Americans listed terrorism as their first concern regarding their country future. Paired up with the presidential election, Sturm, Ruger & Co is currently experiencing a strong momentum for sales growth. Management proved its abilities to efficiently run and expand company's operations, both industrially and financially. Thanks to its large amount of cash on hand, and zero debts, the company has still a lot of leverage to adapt to future prospects of the market. All these elements makes Ruger the best in-class investment within a one year investment horizon, and led my valuation process to set the one year target price at $68.50. I would consider an entry point at $64.00 for a return of 8.47%.

Sturm, Ruger & Co. Inc. (RGR)

CENTER FOR GLOBAL FINANCIAL STUDIES

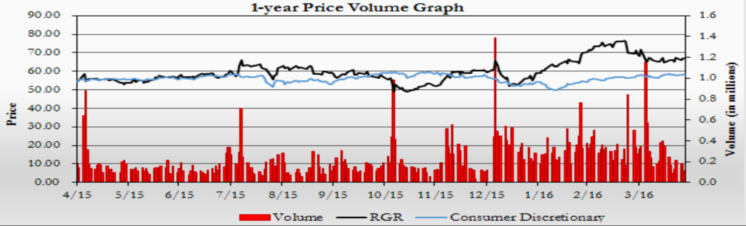
NEUTRAL

Analysis by Lionel Krupka
4/30/2016

Current Price:	$64.03	Intrinsic Value	$62.42
Divident Yield:	1.8%	Target Price	$68.29

Target 1 year Return: 8.47%
Probability of Price Increase: 84.5%

1-year Price Volume Graph



Description

Sturm, Ruger & Company, Inc. designs, manufactures, and sells firearms under the Ruger trademark in the United States.

General Information

Sector	Consumer Discretionary
Industry	Leisure Products
Last Guidance	November 3, 2015
Next earnings date	May 2, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	39%
Effective Operating Tax rate	41%

Market Data

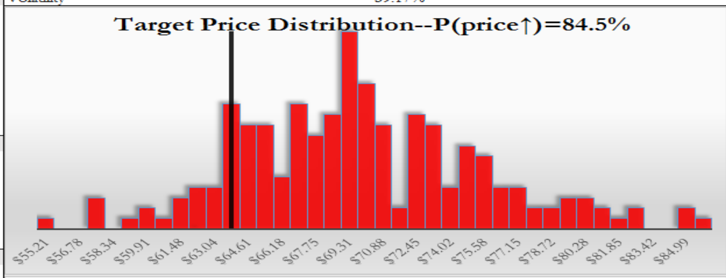
Market Capitalization	$1,214.20
Daily volume (mil)	0.26
Shares outstanding (mil)	18.96
Diluted shares outstanding (mil)	19.37
% shares held by institutions	71%
% shares held by investments Managers	63%
% shares held by hedge funds	8%
% shares held by insiders	3.11%
Short interest	9.12%
Days to cover short interest	5.33
52 week high	$78.09
52-week low	$48.10
Levered Beta	0.87
Volatility	39.17%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	-0.72%	2.73%
3/28/2015	11.62%	4.46%
6/27/2015	2.68%	-8.00%
9/26/2015	-7.52%	-16.85%
12/31/2015	7.55%	28.79%
Mean	2.72%	2.23%
Standard error	3.3%	7.7%

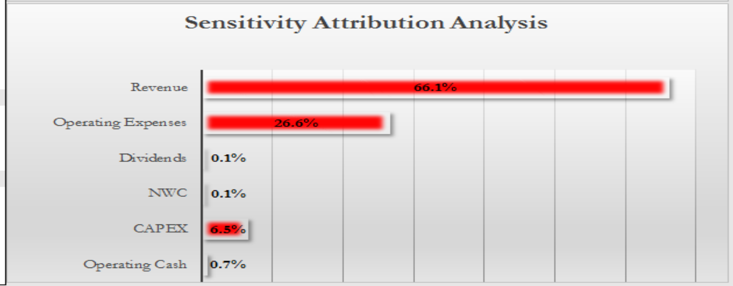
Peers

Smith & Wesson Holding Corporation
Vista Outdoor Inc.

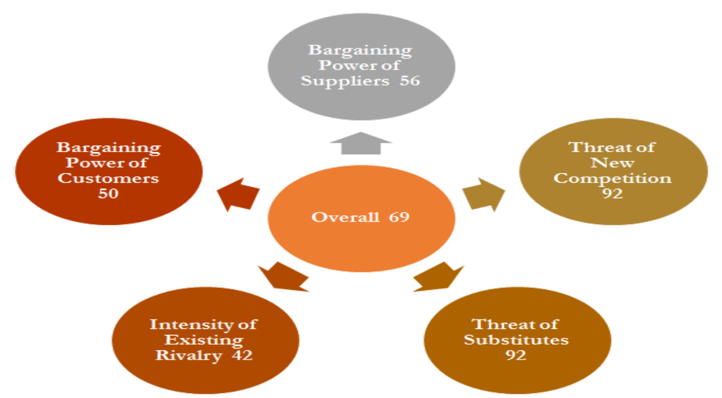


Management	Position	Total compensations growth	Total return to shareholders
Fifer, Michael	Chief Executive Officer and	8.59% per annum over 6y	11.62% per annum over 6y
Killoy, Christopher	President and Chief Operatin	11.35% per annum over 6y	11.62% per annum over 6y
Dineen, Thomas	Chief Financial Officer, Vic	7.08% per annum over 6y	11.62% per annum over 6y
Sullivan, Thomas	Vice President of Newport Op	6.44% per annum over 6y	11.62% per annum over 6y
Lang, Mark	Group Vice President	6.61% per annum over 6y	11.62% per annum over 6y
Reid, Kevin	Vice President, General Coun	N/M	N/M

Profitability	RGR (LTM)	RGR (5 years historical average)	Industry (LTM)
ROIC	34.6%	117.01%	10.76%
NOPAT Margin	15%	16.37%	8.5%
Revenue/Invested Capital	2.38	7.15	1.27
ROE	34.6%	73.58%	12.09%
Adjusted net margin	15%	16.35%	7.7%
Revenue/Adjusted Book Value	2.38	4.50	1.56
Invested Funds	**RGR (LTM)**	**RGR (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	25.2%	26.6%	23%
Estimated Operating Cash/Total Capital	15.7%	17.7%	N/A
Non-cash working Capital/Total Capital	13.9%	13.4%	21%
Invested Capital/Total Capital	90.6%	90.8%	77%
Capital Structure	**RGR (LTM)**	**RGR (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.00	-0.01	0.18
Cost of Existing Debt	202.51%	3.00%	5.32%
Estimated Cost of new Borrowing	0.99%	0.99%	5.32%
CGFS Risk Rating	AAA	AAA	BBB
Unlevered Beta (LTM)	0.87	0.47	0.89
WACC	9.36%	6.62%	8.86%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	1.2%	14.5%	3.70
12/31/2016	6.9%	13.9%	3.49
12/31/2017	3.8%	13.8%	3.35
12/31/2018	3.6%	14.1%	3.41
12/31/2019	3.4%	14.5%	3.47
12/31/2020	3.2%	14.8%	3.54
12/31/2021	3.0%	15.1%	3.61
12/31/2022	2.9%	15.4%	3.68
12/31/2023	2.7%	15.7%	3.75
12/31/2024	2.5%	16.0%	3.83
12/31/2025	2.3%	16.3%	3.90
Continuing Period	2.1%	16.7%	4.02

Period	Invested Capital	Net Claims	Price per share
Base Year	$38.92	-$25.30	$61.68
12/31/2016	$64.20	-$91.73	$67.42
12/31/2017	$85.47	-$168.51	$73.42
12/31/2018	$206.69	-$249.33	$79.59
12/31/2019	$231.61	-$334.83	$85.97
12/31/2020	$248.68	-$423.63	$92.47
12/31/2021	$265.00	-$516.33	$99.12
12/31/2022	$273.16	-$612.81	$105.92
12/31/2023	$280.85	-$712.94	$112.84
12/31/2024	$288.03	-$816.57	$119.89
12/31/2025	$294.69	-$923.51	$127.05
Continuing Period			