

October 1, 2017

**Sturm, Ruger & Company Inc: RGR**  
Nico Dumas

**Sector: Consumer Discretionary**  
**Industry: Leisure Products**

Connecticut-based Sturm, Ruger & Company Inc. is a US small cap company that designs, manufactures, sells, and exports firearms. The company is one of the nation's largest producers of pistols, revolvers, rifles, and shotguns. Ruger has a wide selection of merchandise, encompassing 400 variations of over 30 product lines. The company is known for their rugged, reliable firearms sold to the commercial sporting market. Ruger also makes metal castings and other molding components for a wide variety of markets including sporting goods and military use.

## BUY

Current Price:	\$53.80
Target Price:	\$63.25
Market Cap:	913.6M
Volume:	538,524
EBITDA Margin:	25.56%
WACC:	5.8%
ROE:	30.3%
ROA:	23.3%
P/E:	13.2%

## Catalysts:

- **Short Term(within the year):** Increased tension within the country and a rising defense budget (639 billion, 8.31% increase from Obama's budget)
- **Mid Term(1-2 years):** Trump continuing to deregulate international gun sales (seeking alpha predicted possible 20% increase in sales)
- **Long Term(3+):** Future gun control laws



## Thesis:

Sturm, Ruger & Company Inc., America's largest firearm manufacturer, is a small cap company established in 1949 with high potential upside. Donald Trump plans on raising the country's defense budget from \$590 billion to \$637 billion in 2018, which will call for an increase in firearm production throughout the United States. It just so happens that Sturm, Ruger & Company's total revenue consists of 94% firearms. Exports sales only represent about 3% of these sales, mostly all product content being domestic. Firearm sales to the general public will continue to grow as tension increases in the country with Trump as president. After the LA shooting this past week, the company's stock price rose by 3.6%. As much as it hurts to say, tragedies like this will continue to happen and people will continue to buy firearms for self-defense purposes. Product development is important in this industry; just below 30% of Ruger's firearm sales coming from new products. Spending on research and development has stayed consistent at approximately 10 million per year for the company as they try to cultivate the market with the latest and highest quality firearms.

## Business Overview:

Sturm, Ruger & Company Inc. is the leading firearm manufacturer in the United States of America. This small cap company is supplied with fabricated steel, walnut, birch, maple, and laminated lumber from third party companies. Although some of these materials are limited in supply causing purchasing price to vary, Ruger has suitable quantities of these raw materials in inventory in order to continue to hold out and buy when these material costs are low. Ruger's firearms are generally sold to federally licensed, independent wholesale distributors. These distributors then sell the product to independent retail firearms dealers who are in direct

contact with the market. These end users include customers who use the firearm for commercial sporting purposes, self-defense, gun collections, and law enforcement and other government

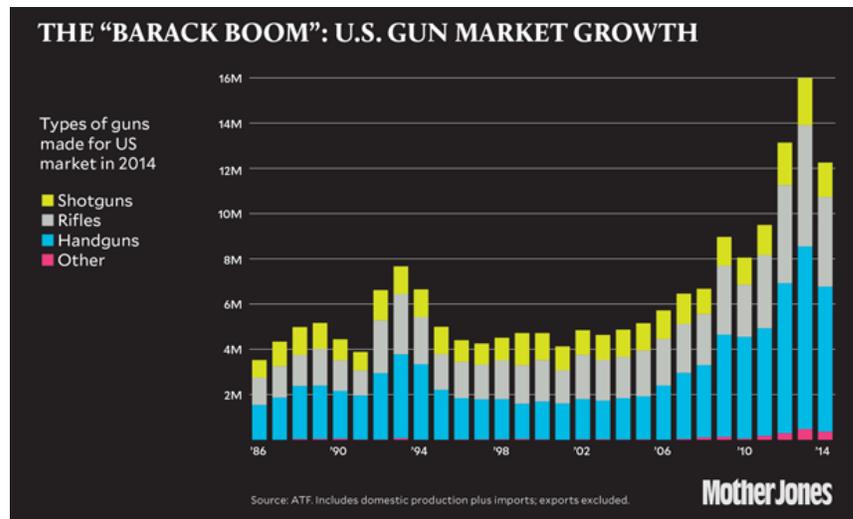


organizations. A few different factors that affect Ruger's profitability include gun control laws, government spending, and the deregulation of international sales. In the second quarter, the company's dividend payout ratio increased from 35% to approximately 83%. This showed me that they are well in the mature stage of their business cycle, paying out dividends at 83% of net income. I do not believe that this devalues the company; the upside is still present based on government policies and regulations. Currently, nearly 97% of Ruger's gun sales are domestic. The biggest catalyst that will effect Ruger's profitability is Trump's deregulation of gun sales overseas. Regulations involving the exports of firearms may be altered without congressional approval; many sources have been proclaiming that changes could be made this fall. Implementation would take several months, but Ruger's stock price would strive if this came to life. The company currently employs 2,110 full-time workers,

25% of which have been with the company for over 10 years. Ruger uses temporary employment concepts in order to supplement its workforce.

## Government Regulations:

Stocks involving the manufacturing and sale of firearms are highly volatile when the government begins to discuss gun laws and regulations. When Obama was in office, gun violence was a discussion brought back to the table often. Barack consistently made efforts to strengthen background checks, limit magazine sizes, and to restart federal gun research. He persisted that acts of terrorism are a direct result of allowing citizens with mental health problems to purchase firearms. As tension increased people began to worry that they would not be able to buy guns in the near future, which caused the gun market to flourish. I believe that with Donald Trump in office, tensions are at a completely new level. Although the president has been known to be in support of gun deregulation, no one can say with certainty that he will stay true to his word. In my opinion, any announcements at all will increase Ruger's stock price. If Trump begins to see acts of terrorism as a result of gun control laws, he will announce this to the general public which will again increase Ruger's sales volume. If this does happen, I suggest we buy and collect short-term profits because the stock price will only soar for a short period of time. If Trump stays true to his stance on firearms, then deregulation will continue and long-term growth is inevitable; Ruger being the largest firearm manufacturer in the United States. International sales take time due to the need for the U.S. State Department and Commerce Department's approval and licensing of the transactions. If the selling of firearms overseas is made less tedious, Ruger will see substantial sales growth. When Hilary Clinton was running for presidency in 2016, Ruger's annual revenue increased almost as high as it was when Obama was in office. Hilary was completely against gun laws and the gun market reacted accordingly. Annual revenue increased for Sturm, Ruger & Company to almost \$665 million, becoming their second most profitable year in business. This goes to show how the government has a direct influence on the gun market.



## Low Valuation:

Sturm, Ruger & Company Inc. is a very cheap stock in the market. On June 12<sup>th</sup> of 2017, Sturm, Ruger & Company's stock price was at a 52-week high of \$68.80 per share. The company then went on to discover a pistol that discharged unintentionally if the safety was utilized incorrectly. Ruger was forced to issue a recall on this type of pistol and record a \$2.5 million expense in the second quarter. Subsequently, the stock price continued to fall over the following three months down to a 52 week low of \$44.80 per. I believe some of this decline in stock price was due to customer uncertainty; Ruger is and always will be the leading manufacturer of

firearms in the United States and the quality of their pistols should not be in question. Even if this company doesn't turn profits immediately, in the long run this stock will gain value. If you look at the forecast of Ruger's EBITDA below it shows how it is expected to rise over the next couple of quarters. I believe that the stock price might also be considerably low simply because Ruger had a bad quarter due to the summer slowdown of sales. Their revenue dropped 21% between the 1<sup>st</sup> and 2<sup>nd</sup> quarters and their stock price is reflective of this. After Ruger's 2<sup>nd</sup> quarter earnings release, the stock fell from nearly \$68 to their 52-week low of \$44.80 as I mentioned above. If you look at the cyclical patterns over the last couple of years, EBITDA generally increased from



quarter 3 to quarter 4 and then to the first quarter of the succeeding year. If we are going to buy this stock, we need to buy it now. If this trend continues, sales in the final two quarters of 2017 will come in higher than the preceding quarter and the stock price will continue to rise over \$60 per share. Another argument I would like to point out that suggests Ruger's cheap value is a recent announcement that the company bought back \$11.3 million worth of shares in the third quarter at a price of \$46.33 per share. In the price chart on the first page, anyone can see the huge spike in trade volume towards the end of September. This was due to Ruger's repurchasing of shares; the company realized how cheap their stock was priced and took advantage of the opportunity. Ruger had a great year in 2016, stock prices hovering in the high \$60s and \$70s per share, and this could easily reoccur in 2018. People are overlooking the fact that they are a well-established company, unpredictable years like 2016 will continue to occur.

### Company Performance:

Name (BICS Best Fit)	Ticker	Mkt Cap	OPM LF	NI Mrgn Adj LF	EBITDA LF Mgn 3Yr Avg	ROIC/WACC Ratio	WACC
Median		1.27B	6.43%	5.30%	19.20%	1.56	6.85%
(100) STURM RUGER & CO INC	RGR US	937.49M	11.60%	7.74%	22.13%	4.94	5.79%
(101) AMERICAN OUTDOOR B...	AOBC US	869.96M	-2.48%	-1.97%	25.96%	4.16	4.15%
(102) AXON ENTERPRISE INC	AXN US	1.26B	1.03%	2.86%	19.20%	2.32	12.81%
(103) MSA SAFETY INC	MSA US	2.91B	5.94%	11.72%	16.10%	0.80	12.17%
(104) VISTA OUTDOOR INC	VSTO US	1.28B	6.92%	2.39%	14.43%	-1.93	5.29%
(105) ORBITAL ATK INC	OA US	7.75B	12.20%	8.14%	--	0.39	7.91%

If you look at the relative valuations above, it shows how Sturm, Ruger & Company Inc. is a best-in-class company compared to its competition. Their operating margin is almost double the median, which shows how efficient they have become in manufacturing their products. American Outdoor Brands, being their top competition, has an operating margin in the negative. Ruger's net income margin is also well above the median, retaining almost 8% of revenue. This number was closer to 13.2% in 2016, but has slowly decreased

due to revenue declining at a faster rate than the cost of revenue. However, net income margin should increase as fall sales continue to rise due to fall hunting seasons and the cyclical pattern of earnings increasing throughout the 3<sup>rd</sup>, 4<sup>th</sup>, and 1<sup>st</sup> quarters. Ruger's EBITDA margin, taking it as a 3 year average, is also above the median even though it is behind American Outdoor Brands by 3-almost 4%. One of the most important ratio's on the chart above is the ROIC/WACC Ratio, which Ruger stands tall at 4.94%. This shows that the company has value. Ruger is generating almost 5% more in profits than it costs to keep the company running. Ruger's last twelve months ROIC, depicted on the right, more than doubles it's competitors. This is due to their lack of debt and low cost of borrowing. The only debt Ruger takes on is leasing four of it's facilities, all leases involve contracts of under three years. These leases come to a total of \$461,000 accompanied by purchasing agreements totaling about \$13.5 million, mostly concerning raw materials for production. Ruger has a total debt to market cap ratio of 0%, a z score credit rating of AAA, and an f score credit rating of BBB as of 7/1/2017. This company has a very low default risk; bankruptcy not being an option in the foreseeable future. If the deregulation of firearms overseas continues, Ruger could easily take on debt to finance expansion of their company. Currently, only 3% of their sales come from international exports. When Trump starts to ease overseas distribution, Ruger will want to enter the new market. If they decide to expand and start manufacturing internationally, Ruger's international presence would cause revenue to increase substantially.

ROIC (NOPAT/IC)		
	History	LTM
RGR	65.2%	47.8%
Competitors	35.1%	21.9%
Target	47.8%	

## Ownership and Management:

STURM RUGER & CO INC				CUSIP 86415910	
1) Current 2) Historical 3) Matrix 4) Ownership Summary 5) Insider Transactions 6) Options 7) Debt					
Compare Current Stats Against 10/02/16					
Ownership Type	10/02/16	Curr ↓	Change		
11) Investment Advisor	82.93	87.62	+4.69	<input checked="" type="checkbox"/>	
12) Individual	2.85	2.88	+0.03	<input type="checkbox"/>	
13) Hedge Fund Manager	8.41	2.82	-5.59	<input type="checkbox"/>	
14) Sovereign Wealth Fund		1.99		<input type="checkbox"/>	
15) Bank	1.20	1.55	+0.35	<input type="checkbox"/>	
16) Pension Fund	1.71	1.08	-0.63	<input type="checkbox"/>	
17) Insurance Company	0.83	0.66	-0.17	<input type="checkbox"/>	
18) Brokerage	0.33	0.59	+0.26	<input type="checkbox"/>	
19) Government	1.30	0.27	-1.03	<input type="checkbox"/>	
20) Unclassified	0.00	0.24	+0.24	<input type="checkbox"/>	
21) Holding Company	0.32	0.21	-0.11	<input type="checkbox"/>	

Sturm, Ruger & Company Inc. currently has 17.7 million shares outstanding. Investment Advisors currently have the largest holding on the company, their top shareholders being Blackrock and Vanguard. Since 2016 Hedge Funds have passed on 5.59% ownership, collecting their profits and moving on to the next company. Abdiel Capital Advisors was the largest Hedge Fund that sold their shares, which accounted for almost 2% of RGR, due to a switch in sectors. They wanted to focus more on industrials and technology, rather than keep their consumer discretionary holdings. This caused individual investors to take over the second leading ownership position in the company. Since August of this year, Hedge Fund Managers haven't made any share transactions which might show that they see potential in the short term as well. I believe that when this third quarter earnings report comes out, it is going to show sales growth and we will see an upward sloping share price. Moving on to RGR's management, Ruger's President, CEO, and COO is a man named Christopher

John Killoy. He has been with the company since 2003, starting out as the Executive Director of Sales and Marketing. He took over his current position as CEO in May succeeding the previous CEO who decided to retire after 11 years as head of the company. The stock price dropped after Killoy was announced CEO, and I believe that this was because people did not want to put trust into someone new. He has been with the company for almost 15 years, and knows how to steer it in the correct direction. Ruger is a well-established company with a clean balance sheet. Killoy, having experience in marketing and sales, may look to start marketing Ruger's products better. The company needs to boost sales volume, and they have the right man as CEO to get this done.

## Industry Outlook:

Dow's highest closing record was just recorded on October 5<sup>th</sup>. The economy is booming right now and we have been in a bullish market for the past 8 years. The unemployment rate is low and people are spending money. With a bullish market and low unemployment rate comes an increase in the consumer discretionary

sector. People will continue to buy leisure products if the economy stays trending upward. Concerning the consumer discretionary sector, as you can tell from the following charts, prices along with market cap are both rising. Profitability in this sector is inevitable as the S&P continues to reach new heights. The YOY growth rate of the S&P 500 Consumer Discretionary Index is currently 12.82% and I believe this number could easily rise to 15-20 percent by this time in 2018. We need to purchase more stocks in the consumer discretionary sector, especially with baby boomers beginning to retire. These retirees will start to purchase more leisure products now that they are out of the workforce. Many of these baby boomers will have available time to hunt as well, which is where Ruger could benefit. Gun sales are constant during the last few months of each year due to fall hunting. Most big game seasons take place during the fall due to the lack of parasites on animals' bodies. The cold weather kills off all of the insects and makes it safe to consume wildlife animals. Consumers will continue to purchase firearms for sport purposes out of pure enjoyment. I, being a hunter, find it extremely relaxing to go out on a brisk fall morning and sit in a tree stand. It is rejuvenating to be alone in the forest listening to nature. Hunters are very passionate about the sport; they don't fluctuate in and out of the market. This causes the demand for new rifles to always be present.



## **Conclusion:**

I propose that we should place a buy limit at \$52.50 per share, seeing how the market just reacted to the LA shooting. RGR's stock price increased 3.6% over the matter of a day so it should fluctuate back down to around \$52. The third quarter earnings release does not come out until early November, and this is where I really see the stock starting to gain momentum. The company had a bad second quarter because of a recall combined with the slow summer sales season. When investors see sales increase in the third quarter earnings report, this stock will get right back on track. The increase in the defense budget will also trickle down into Ruger's pockets, being the largest firearm manufacturer in the United States. Trump will continue to discuss the deregulation of international firearm sales, which should increase RGR's value substantially. Gun control laws will definitely continue to be discussed in the future, which always correlates with RGR's stock price. This is a clear buy, seeing how well established the company is and the potential entrance into foreign markets. Buying this company at its current price would be the right decision, but I believe we could get it even cheaper at around \$52.50 per share.

**Sturm, Ruger & Company, Inc. (RGR)**

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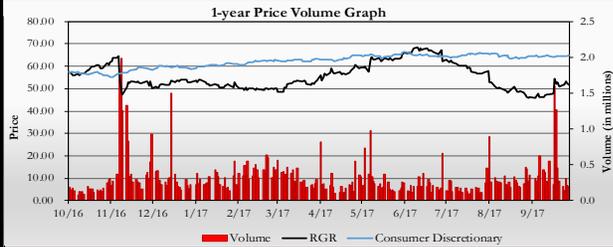
**NEUTRAL**

Analysis by Nico Dumas  
10/6/2017

Current Price: **\$54.65**  
Dividend Yield: **2.8%**

Intrinsic Value: **\$60.26**  
Target Price: **\$61.31**

Target 1 year Return: 14.99%  
Probability of Price Increase: 79.33%

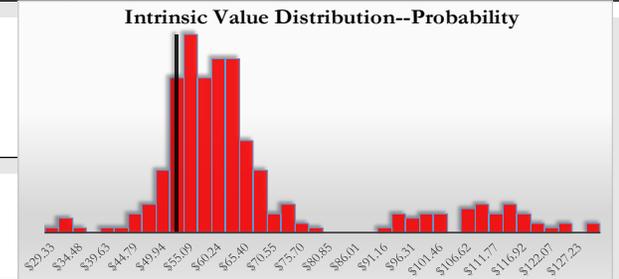


Description	
Sturm, Ruger & Company, Inc. designs, manufactures, and sells firearms under the Ruger trademark in the United States.	
General Information	
Sector	Consumer Discretionary
Industry	Leisure Products
Last Guidance	November 3, 2015
Next earnings date	November 1, 2017
Estimated Country Risk Premium	5.69%
Effective Tax rate	24%
Effective Operating Tax rate	31%

Market Data	
Market Capitalization	\$965.77
Daily volume (mil)	0.54
Shares outstanding (mil)	17.67
Diluted shares outstanding (mil)	18.53
% shares held by institutions	84%
% shares held by investments Managers	75%
% shares held by hedge funds	3%
% shares held by insiders	2.77%
Short interest	22.37%
Days to cover short interest	12.88
52 week high	\$68.80
52-week low	\$44.80
Volatility	37.54%

Past Earning Surprises		
Quarter ending	Revenue	EBITDA
7/2/2016	N/A	N/A
10/1/2016	N/A	N/A
12/31/2016	5.10%	N/A
4/1/2017	2.80%	11.91%
7/1/2017	-17.38%	-39.35%
Mean	-3.16%	-13.72%
Standard error	7.1%	25.6%

Peers	
American Outdoor Brands Corporation	
Vista Outdoor Inc.	

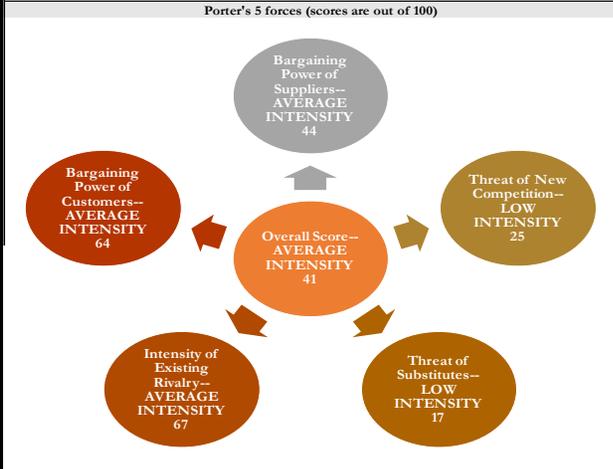
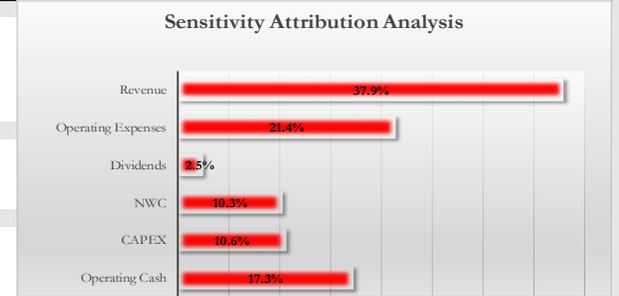


Management	
Killoy, Christopher	President, CEO & Director
Dineen, Thomas	CFO, Senior VP of Finance &
Sullivan, Thomas	Senior Vice President of Ope
Lang, Mark	Group Vice President
Colbert, Sarah	Vice President of Administra
Reid, Kevin	VP, General Counsel & Corpor

Total compensations growth		Total return to shareholders	
-1.28% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y
-1.95% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y
-1.82% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y
-1.39% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y	8.87% per annum over 5y
N/M	N/M	N/M	N/M
N/M	N/M	N/M	N/M

Profitability		RGR (LTM)		RGR (5 years historical average)		Peers' Median (LTM)	
Return on Capital (GAAP)	47.8%	65.15%	21.85%	65.15%	21.85%		
Operating Margin	14%	15.08%	7.78%	15.08%	7.78%		
Revenue/Capital (GAAP)	3.48	4.32	2.81	4.32	2.81		
ROE (GAAP)	27.5%	38.4%	9.0%	38.4%	9.0%		
Net margin	11.7%	13.2%	7.3%	13.2%	7.3%		
Revenue/Book Value (GAAP)	2.34	2.92	1.25	2.92	1.25		

Invested Funds		RGR (LTM)		RGR (5 years historical average)		Peers' Median (LTM)	
Cash/Capital	19.3%	31.7%	11.8%	31.7%	11.8%		
NWC/Capital	23.7%	14.0%	37.0%	14.0%	37.0%		
Operating Assets/Capital	57.0%	56.8%	30.8%	56.8%	30.8%		
Goodwill/Capital	0.0%	0.0%	20.3%	0.0%	20.3%		



Period	Revenue Growth Forecast
Base Year	1%
7/1/2018	-15%
7/1/2019	-13%
7/1/2020	15%
7/1/2021	-6%
7/1/2022	-5%
7/1/2023	-4%
7/1/2024	15%
7/1/2025	-2%
7/1/2026	0%
7/1/2027	1%
Continuing Period	2%

Valuation	Revenue to Capital Forecast
NOPAT Margin Forecast	
11.3%	2.08
15.8%	2.06
15.9%	1.40
17.3%	1.34
16.5%	1.04
16.6%	0.86
16.8%	0.73
17.5%	0.75
17.0%	0.66
17.0%	0.60
17.1%	0.55
17.1%	0.52

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	23.4%	5.7%	\$54.13
7/1/2018	32.6%	5.7%	\$56.39
7/1/2019	22.3%	5.7%	\$58.90
7/1/2020	23.2%	5.7%	\$61.17
7/1/2021	17.3%	10.1%	\$65.69
7/1/2022	14.3%	10.1%	\$70.29
7/1/2023	12.3%	9.7%	\$74.78
7/1/2024	13.2%	9.9%	\$79.33
7/1/2025	11.3%	9.9%	\$84.13
7/1/2026	10.2%	9.9%	\$89.04
7/1/2027	9.5%	9.9%	\$94.06
Continuing Period	8.9%	9.9%	