

March 2017

S Sturm, Ruger, & Company: RGR (Long)
John Garrity

Sector: Industrials
Industry: Munitions and Small Arms
Current Price: \$50.60
Target Price: \$57.15

Company Description:

S Sturm, Ruger & Company is the business of designing, manufacturing, and the sale of firearms to domestic customers, and do not manufacture any fully-automatic weapons. Since 1949 Sturm, Ruger & Co. have been primarily selling rifles, pistols, and revolvers through independent wholesale distributors. Models include hunting and target rifles, single & double action revolvers, muzzle loading guns, and double-barreled shotguns. Sturm, Ruger & Co. also manufacture and sell investment castings made from steel alloy and metal injection molding parts for commercial and military markets. This makes up about 6 percent of revenues, and has been growing since 2015. Ruger almost exclusively sells within the United States.

Key Statistics:

<u>Market Price:</u>	\$50.60	<u>ROE:</u>	34.87%
<u>Market Cap:</u>	\$916.1M	<u>Net Income</u>	
<u>WACC:</u>	5.77%	<u>Margin:</u>	13.17%
<u>ROIC:</u>	34.55%	<u>P/E:</u>	11.09 x
<u>EBITDA Margin:</u>	24.99%	<u>Div. Yield:</u>	3.42%
<u>Ke:</u>	5.77%		

Catalysts:

- > Fewer restrictions on guns
- > Income growth
- > New Products
- > May 1st earnings announcement
- > Company position in the industry
- > Military expenditure



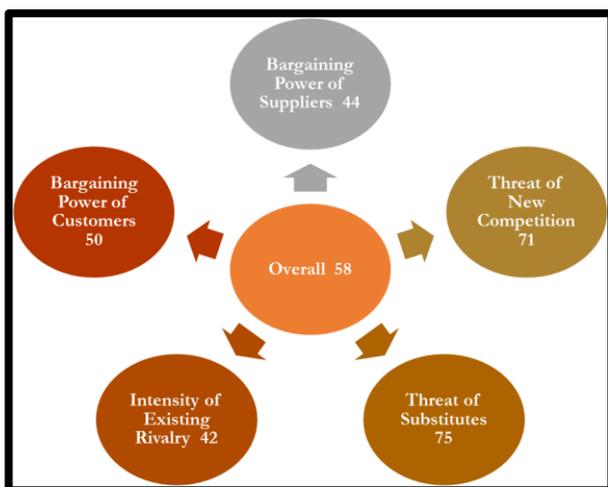
Thesis:

Sturm, Ruger, & Co. was founded in 1949 in Southport, Connecticut out of a small machine shop William B. Ruger and Alexander McCormick-Sturm. Ruger & Co. design, manufacture, and sell pistols, revolvers, and shotguns. Today, the company is the largest gun maker in the United States, according to the Bureau of Alcohol, Tobacco, Firearms, & Explosives. It is important that in their environment, new products are introduced and well accepted. For the first nine months of 2016, new products generated 32 percent of total revenue for that period. Although it is typical for gun sales to slow during a new administration, including one that was as good to the industry as the Obama administration. Still, Ruger continues to be one of the biggest players in the Small Arms industry, accounting for almost a fourth of the industry revenue. As American Outdoor Brands Corp., formerly Smith & Wesson, is transitioning into outdoor sports, it will transition into the only “pure-play” gun stock. The Trump Administration’s policies can open the door back up for Ruger in a way that would move its stock price up away from near its 52 week low.

Industry Outlook:

Over the last four years in particular, gun owners were stocking up on guns and ammunition to prepare for the Clinton Administration. Over that time small arms and defense stocks cashed in, and now Americans feel comfortable with their Second Amendment rights, which would mean less excessive purchases. Of the publicly traded firearms manufacturers, only Forjas Taurus is the outside the United States; as they are in Brazil. Ruger and American Outdoor Brands Corp. have a strong hold on the industry, combining to make up 56.37 percent of the industry revenue. To capture the customer in the Small Arms industry, a company would need broad product lines, extensive capital resources, and innovative teams. Recently AOBC, formerly Smith & Wesson, has announced that they will begin a transition into more outdoor sports and equipment. Favorable trends in the industry leave Ruger in a good position because target shooting participation in the United States is on the rise. Of established shooters in 2016, those with more than 5 years of experience, the average demographic is a

43 year old with a 78 percent chance of being a male. Whereas those with less than 5 years of experience, the average demographic is 33 with a 63 percent chance of being female. In this newer demographic, 77 percent started after age 18, and only 29 percent shot a target in 2012. Of experienced target shooters, 56 percent shot a target in 2012, and 81 percent started before age 18. This demographic shift will only become more concentrated and valuable because these young individuals, including women will start and continue their purchases. In the near future, Sturm, Ruger, and Company could be the only pure gun stock to trade on.



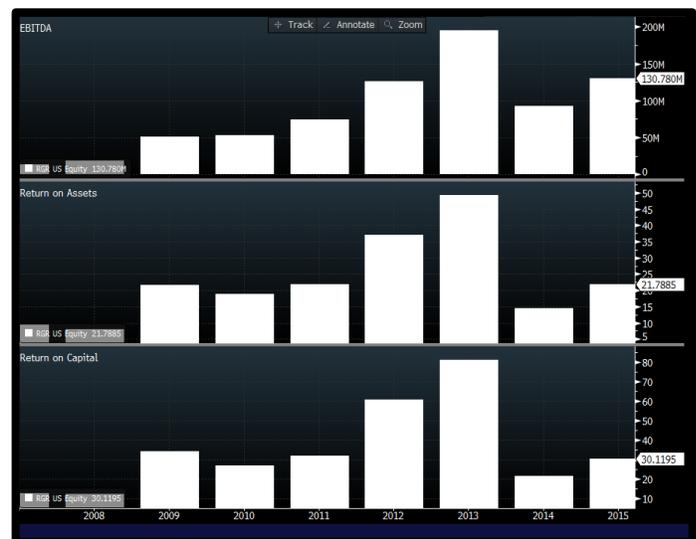
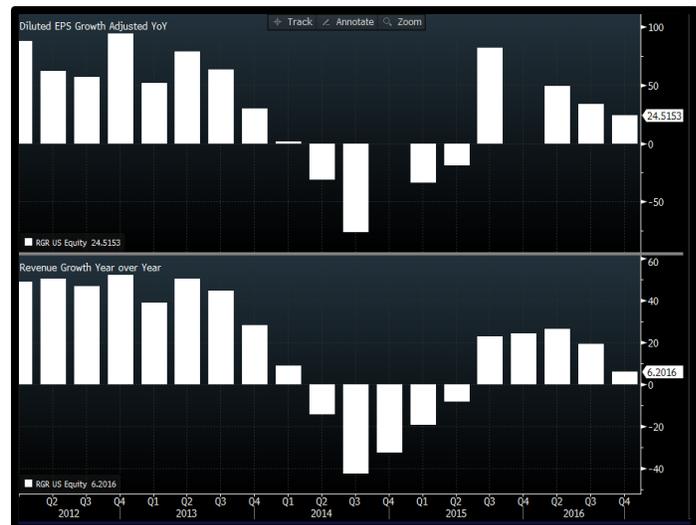
Products:

Ruger designs, manufactures, and sells rifles, pistols (modern handguns that feed ammunition via clips), and revolvers (typically spinning 6 shell cylinder). They are invested into making only the best guns on the market Revolvers are the main gun for self-defense for reliability and simplicity of use. Ruger also sells shotguns, but they do not see it as a vital part of their business model because management deems them less profitable. The most notable advantage Ruger has over AOCB is that Ruger has successful product lines of bolt action rimfire

rifles and airguns, whereas American Outdoor Brands Corp manufacture neither. The important matter here is that both of these guns are typically the first owned gun for first gun shot. This gives Ruger a large advantage for those looking to try out shooting or owning a gun for the first time. Quality at Ruger is key, so it test shoots every gun they sell, as well as tests the durability to test the maximum pressure level Ruger also manufactures investment casting which they sell to many corporations and the military, and have seen an slight increase in the industrial mold segment, which is now 6.5 percent of their revenue.

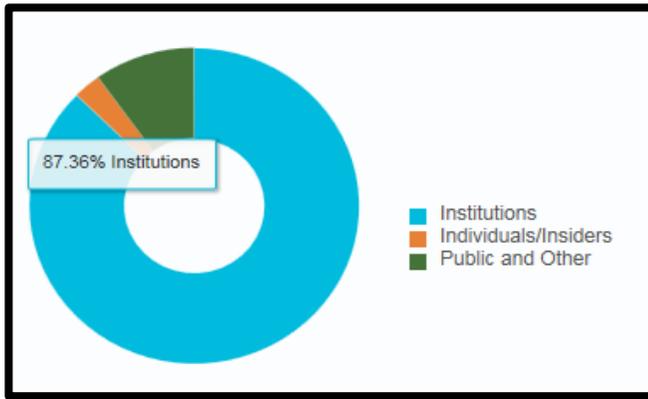
Revenue:

During the fourth quarter of 2016, Ruger repurchased 1.5 percent of their outstanding shares for \$49.43, at a total purchase of 14 million. The company prefers to keep their P/E ratio above 10, so they will repurchase shares when they feel a low evaluation. The company experienced a decline in overall performance during 2014 to 2015 mainly because they did not discount their products during the cyclical downturn. With Consumer Comfort at its highest level in a decade, and personal income increasing at a pace faster than expected. They currently own 24.23 percent of the revenue of the Small Arms Industry, and it will only grow with the slow recession of AOCB in the firearms industry. As displayed in the graph, Ruger's EPS and Revenue growth started to dip in 2014, recovered in 2015, and got hit by the Trump election in late 2016. There is plenty of room for growth with the gradual exit of the only other big player in an industry with high barriers to entry, as well as a favorable, shifting demographic. Although the EPS and Revenue has seen a decline since digging out of 2014/2015, EBITDA, return on assets, and return on capital have all seen positive growth over the same period. Even through Ruger announced on February 23rd that they missed earnings, which resulted in the stock falling .9 percent, they have beat consensus estimates over the last 6 periods by an average of 13.98 percent. The May 1st earning report will be key to how the company responds to the early days of the highly volatile market under the new administration.



Company Structure:

Ruger is made up of no debt, and are funded entirely funded through 265.9 million in equity. A large part of their business, 32.76 percent, is comprised of cash and short term investments. Although the structure can be seen as conservative with no short or long-term debt, the margins are enough to get efficient returns. The net income margin confidently beats out the industry average of 10.17 percent. In the last twelve months, return



on invested capital of 45 percent beats out the 44 competitors by 25 percent, proving its profitability, even through sub-par revenue results. Institutions are the top holders of Ruger, making up 87 percent of ownership. Making up of these institutions, BlackRock, Inc. and the Vanguard group make up roughly 26 percent together.

Cash Flow:

Ruger improved on its cash flow by more than 10 percent compared to 2016 year, which was much better than the 7 percent decline of the years prior. Cash on the balance sheet subsequently went up, but by 26 percent from 69 million to 87 million. Liquidity of Ruger is no issue, as it has a current ratio of 2.7, so any long term obligations are certainly achievable. The fact that the cash balance has not recently decreasing suggests that the company is in no down turn at all, but in a phase that is more focused on long term direction.

Future Policies under the Trump Administration:

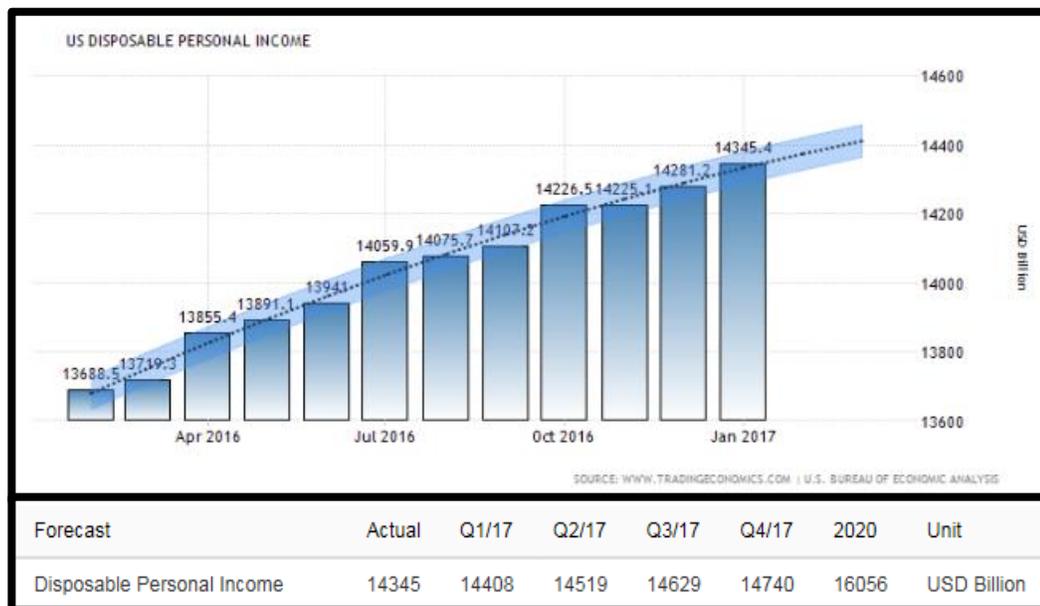
Typically, when a new president, especially a Republican, enters the White House, gun sales generally see a dip because of the security of the Second Amendment. That is exactly what Ruger experienced leading up to the election and shortly after. The stock price dipped over 11 percent upon the election of Donald Trump. The recent Presidential election was something like the United States has never seen before. America will continue to experience change of the demographics associated with guns. Most of new gun sales are by younger persons willing to try out target shooting, or other kinds, and in the near future these fruits will blossom. Reason being, those who either support or strongly believe in the Second Amendment take owning a firearm seriously. These types of people often have many different types of uses for guns, thus leading to the purchases of many different kinds, from self-defense to hunting and sporting. Trump has many gun reforms that he expects to pass relatively quick, largely thanks to the NRA being his largest super-PAC contributor. The Trump administration anticipates to end gun-free zone in military bases and federal property. This would increase the amount of guns needed by the military. In addition, Trump says he will get a national conceal to carry law passed the House and Senate within the first three months of his term. Ruger can significantly benefit from the Hearing Protection Act, which



would eliminate the \$200 tax on silencers, as well as making it easier to acquire a silencer. Last but not least, reforming NICS background checks will produce more accurate and effective screenings so that everyone is treated on an equal playing field. This will create a stable confidence around the mystery of the safety of guns. Considering Ruger is set to become the only pure play gun retailer, the near future is promising for increased revenue. In addition, the Fed has sought to increase interest rates, which leaves Ruger in a strong position because they won't have to worry about the rising cost of borrowing.

Personal Income Growth:

According to a 2016 study from Harvard & Northeastern, 22 percent of American adults are gun owners. Broken down further; about half own two or one, about a third own between three and seven, and 14 percent own between 8 and 140 guns each. The average amount of guns owned of the top 14 percent is 17. This shows that there is a defined niche within gun owners that is similar to collecting antiques, cars, or guitars.



The NRA even sponsors annual gun collector's shows to more than 120 gun collector's clubs across the nation. Guns are relatively cheap to the customer, ranging from \$300 - \$750 for a pistol. Since a sharp decrease in 2013, US per capita disposable income has steadily increased since. By the end of the 4th quarter of 2017, disposable

income will increase 2.7 percent. With disposable income on the rise, those who already own guns and are seeking to expand their collection due to the latest model that came out, or those who are part of the new wave of consumers that start trying out guns later in life and the rapidly growing women demographic. The new policies coupled with the rising disposable income, Ruger is in a good place it wait for their moment when new gun owners start their first purchases.

Conclusion:

Ruger is in the process of reversing the long term trend of decreasing profits. Earnings per share have increased almost 17 percent in the last twelve months and increasing margins shows that Ruger likely is gaining market share without much of a financial sacrifice. Ruger is able to obtain above-average return on equity and operating margin shows that they are very efficient no matter the amount of revenue they generate. The outlook is very positive for Americans regarding income, and the regulations on guns will decrease causing the demand for guns to increase in the near future. Ruger is in an undervalued industry with no large threat to their market share. Strong financials, constant new products with extreme detail, and an increase in overall interest from different demographics including females and the younger generation.

Sturm, Ruger & Company, Inc. (RGR)

CENTER FOR GLOBAL FINANCIAL STUDIES

NEUTRAL

Analysis by John Garrity

Current Price: **\$51.88**

Intrinsic Value: **\$47.77**

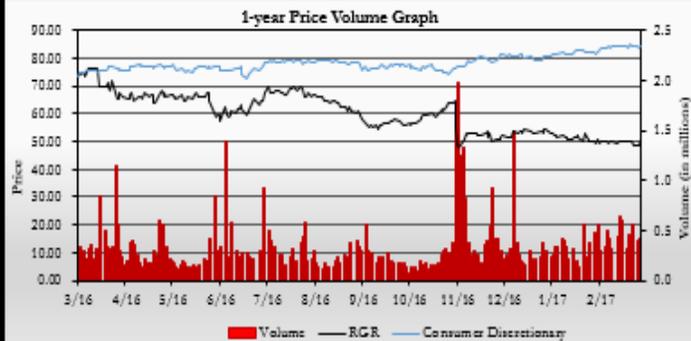
Target 1 year Return: 13.45%

3/10/2017

Divident Yield: **3.3%**

Target Price: **\$57.15**

Probability of Price Increase: 100%

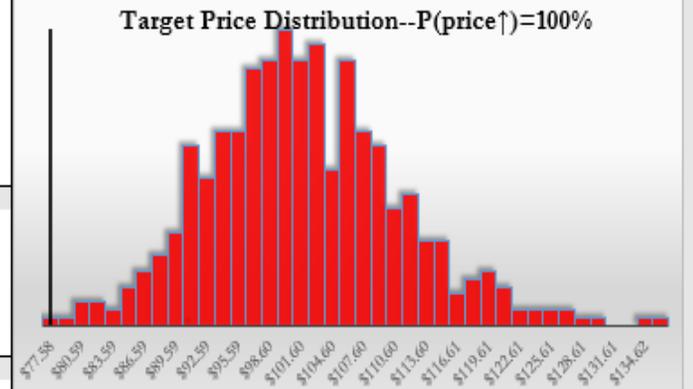


Description
Sturm, Ruger & Company, Inc. designs, manufactures, and sells firearms under the Ruger trademark in the United States.

General Information	
Sector	Consumer Discretionary
Industry	Leisure Products
Last Guidance	November 3, 2015
Next earnings date	NM
Estimated Country Risk Premium	6.41%
Effective Tax rate	39%
Effective Operating Tax rate	38%

Market Data	
Market Capitalization	\$916.11
Daily volume (mil)	0.22
Shares outstanding (mil)	18.10
Diluted shares outstanding (mil)	19.05
% shares held by institutions	74%
% shares held by investments Managers	73%
% shares held by hedge funds	7%
% shares held by insiders	2.74%
Short interest	29.67%
Days to cover short interest	15.32
52 week high	\$78.09
52-week low	\$47.15
Levered Beta	0.59
Volatility	38.94%

Quarter ending	Past Earning Surprises	EBITDA	Peers
12/31/2015	Revenue 7.55%	28.79%	American Outdoor Brands Corporation
4/2/2016	14.79%	19.97%	Vista Outdoor Inc.
7/2/2016	N/A	N/A	
10/1/2016	N/A	N/A	
12/31/2016	5.10%	N/A	
Mean	9.15%	24.38%	
Standard error	2.9%	4.4%	



Management	Position	Total compensations grow	Total return to shareholders
Fifer, Michael	Chief Executive Officer and	14.19% per annum over 5y	20.22% per annum over 5y
Killooy, Christopher	President, Chief Operating O	16.87% per annum over 5y	20.22% per annum over 5y
Dineen, Thomas	Chief Financial Officer, Vic	10.54% per annum over 5y	20.22% per annum over 5y
Sullivan, Thomas	Vice President of Newport Op	10.67% per annum over 5y	20.22% per annum over 5y
Lang, Mark	Group Vice President	10.82% per annum over 5y	20.22% per annum over 5y
Reid, Kevin	Vice President, General Coun	NM	NM

Profitability	RGR (LTM)	RGR (5 years historical ave)	Industry (LTM)
ROIC	35.1%	97.57%	11.09%
NOPAT Margin	14%	14.67%	8.4%
Revenue/Invested Capital	2.49	6.65	1.32
RDE	33.0%	66.20%	12.81%
Adjusted net margin	14%	14.66%	7.3%
Revenue/Adjusted Book Value	2.34	4.52	1.75

Invested Funds	RGR (LTM)	RGR (5 years historical ave)	Industry (LTM)
Total Cash/Total Capital	25.8%	21.8%	27%
Estimated Operating Cash/Total Capital	18.5%	18.2%	N/A
Non-cash working Capital/Total Capital	16.5%	14.2%	19%
Invested Capital/Total Capital	92.0%	94.8%	73%

Capital Structure	RGR (LTM)	RGR (5 years historical ave)	Industry (LTM)
Total Debt/Common Equity (LTM)	0.00	0.00	0.21
Cost of Existing Debt		48.66%	4.58%
Estimated Cost of new Borrowing	5.77%	8.62%	4.58%
CGFS Risk Rating	D	D	C
Unlevered Beta (LTM)	0.59	0.64	0.77
WACC	8.00%	6.52%	7.25%

