

Mossberg's Investor Digest

Best Idea Profile:

Smith & Wesson Holding Corporation (NASDAQ:SWHC)

DESCRIPTION:

Smith & Wesson Holding Corporation produces quality handguns, law enforcement products and firearm safety and security products. It has been selling to law enforcement and military personnel, as well as enthusiasts in target shooting, hunting, and collecting for more than 160 years. The consumer market makes up 85% of sales, while the professional market is 15%. Familiar brands include Smith & Wesson, M&P, Thompson/Center Arms, Caldwell, and Wheeler. Company facilities are located in Massachusetts, Maine, Missouri, and Connecticut. Headquarters is in Springfield, Massachusetts, and the company employs almost 1,800.

KEY INVESTMENT CONSIDERATIONS:

Reason for Optimism – The firearm industry saw a big decline in 2014, which put tremendous pressure on SWHC. But this decline followed an extraordinary 2013, when more than 21 million applications for firearms were submitted to the National Instant Criminal Background Check System. NICS is the most consistent measure of demand as these are the applications that are conducted at the point of sale and tracked by the FBI. Calendar 2013 was the eleventh consecutive year of NICS increase. Was this the Obama effect? The Sandy Hook effect? Regardless, this inflated level of demand ceased in 2014, and produced rapid revenue declines and large inventories industry wide. This indicator now indicates a turnaround and more interest in firearm related sales that will accelerate the recovery. One industry expert estimates the industry is growing at a 7% to 9% annual rate.

Accretive Acquisition – Smith & Wesson acquired Battenfeld Technologies, a maker of hunting and shooting accessories, in late 2014. It supplies major retailers including Cabelas, Bass Pro, and Dick's Sporting Goods, and expands the company's product offerings, stays within its core firearms business, and adds a large production facility. The \$130 million acquisition price cleans out much of the cash and stretches the debt facility. However, at the time of the acquisition, management stated it expected a revenue contribution of \$55 million and \$15 million additional EBITDA per year.

Iconic Brands – Smith & Wesson owns brands that have more than 90% awareness among people who own firearms or intend to buy within a year. And how much more iconic can it be: It is the manufacturer of the 44 Magnum used in the *Dirty Harry* films.

Experienced Management Team – The president and chief financial officer each have more than 20 years of experience. The remainder of the team comes from a diverse range of retail, technical and financial backgrounds.

Reasons to Own – The consumer trends driving handgun growth include concealed carry, personal protection, and recreation. Pistols are driving the growth in handguns, as they now represent over 85% of handguns sold.

VALUATION:

The company guided estimates for revenue and earnings significantly higher on January 20. The stock traded up more than 40% off its low, but is still trading at only 13 times next year's earnings per share estimate. Management has a history of positive surprises, so there may be more on the way. Consensus earnings estimates are up and, despite the big share leap in January, there may be more room to incorporate improving conditions.

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Investment Data (as of 2/23/15)

Recent Price	\$12.83
52-Week Range	\$9.03 - \$17.28
Fiscal Year End	April 30
Dividend	NA
Yield	NA
Shares Outstanding	53.7 M
Average Trading Volume (3 mos)	1.4 M
Market Capitalization	\$689.0 M
Cash	\$64.4 M
Long-term Debt	\$175.0 M
Enterprise Value (EV)	\$788.9 M
Book Value	\$2.97
TTM Revenue	\$556.6 M
P/ Revenue	1.2x
TTM EPS	\$1.16
P/ EPS	11.0x
TTM EBITDA	\$133.1 M
EV/ EBITDA	5.9x