

Law Enforcement Industry

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Adjusted NICS Checks Down 12% YTD.

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Adjusted National Instant Criminal Background Check System (NICS) firearm background checks continued to decline in November and year-to-date, adjusted checks are down 12% from a year ago. We expect 2022 will be the second consecutive year of double-digit declines in adjusted checks, a proxy for domestic firearm sales.

We expect 2022 will be the second consecutive year of double-digit declines in adjusted NICS firearm background checks, a proxy for domestic firearm sales. The industry continues to adjust after multiple significant catalysts resulted in a well-above trend of NICS checks and sales in 2020.

2020 was an unusual year for firearm sales driven by violence in many cities across the U. S., calls to defund the police, excess cash in consumer pockets from federal payments to cope with the COVID lockdowns, significant monetary stimulus from the Fed and greater time spent at home by consumers. All of these combined to generate a 60% increase in adjusted NICS checks in 2020 and an almost doubling of firearm sales (based on ATF tax data) from 2019 to 2021, to \$11.6 billion.

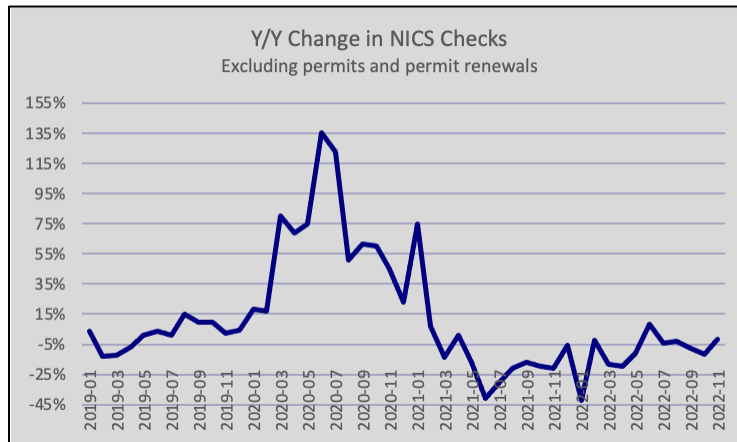
Beginning in mid-2020 the growth rate of NICS checks slowed and in early 2021 adjusted NICS checks began to decline year-over-year and have remained negative in all but two of the past 21 months. The rapid increase in interest rates by the Fed has resulted in reductions in inventory and a more cautious consumer. An evenly balanced federal legislature and a Supreme Court high skeptical of Second Amendment infringements have lessened the desire by consumers to purchase firearms fearing future ownership restrictions.

During the George W. Bush presidency adjusted NICS checks grew at a 2.4% CAGR; during the Obama presidency 7.3%; during the Trump presidency 7.5%. But the Trump years include the pandemic year of 2020. Prior to that year, adjusted NICS checks had declined at a 5.8% CAGR from 2016 to 2019. Even with the declines in the past two years, an additional decline of 10% would bring adjusted NICS checks back to trend.

Suppliers of firearms, self-protection devices and law enforcement equipment have seen sharp declines in their share prices this year as the reduced demand has led to significant declines in revenue and EBITDA estimates for this year and next. For 2023 consensus revenue estimates assume a resumption of growth. The median sales growth for our index of companies in the sector is 17% (equal-weighted) and 5% (sales-weighted). However, if the reversion to the trend on consumer firearm sales continues and Fed rate increases impact government income through reduced tax collections, these forecasts could be at risk.

The National Instant Criminal Background Check System (NICS) provides a proxy for firearm sales. The Brady Handgun Violence Prevention Act of 1993 requires the FBI to check whether prospective firearms or explosives buyers' names and birth years match entries in federal databases of 1) criminal histories in the Interstate Identification Index (III); 2) wanted persons, subjects of protection orders, and other persons who may pose a threat to officers and public safety in the National Crime Information Center (NCIC) database; 3) persons prohibited from possessing or receiving a firearm in the NICS Indices, and 4) non-U.S. citizens attempting to receive firearms. Total NICS checks include requests for permits and permit renewals, and excluding these two categories or adjusted NICS checks, provides a proxy for gun purchases in the U.S.

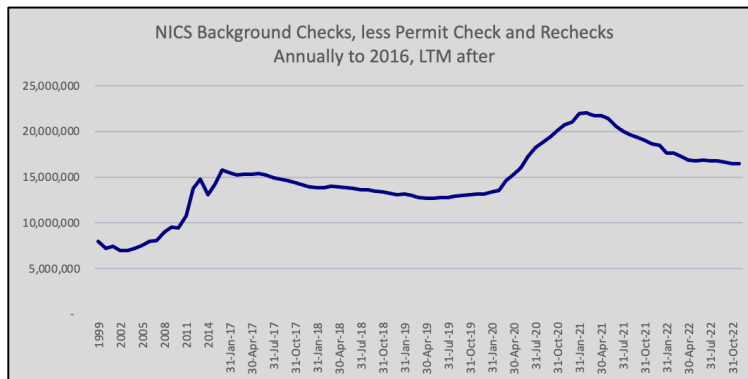
Adjusted NICS checks averaged 13.9 million per year from 2017 through early 2020 and began growing rapidly beginning March of 2020. The year-over-year growth rate peaked in June of 2020 at 136% and trailing twelve-month adjusted NICS checks peaked at 22.1 million in February 2021. Since June of 2020, the rate of change has declined and turned negative in March 2021. The year-over-year change in adjusted NICS checks has been negative in all but two of the subsequent months. As of November 2022, trailing twelve-month adjusted NICS checks were 16.5 million, down 25% from the peak but still 19% above the average from 2017 through early 2020.



Source: "NICS Firearm Background Checks: Month and Year by State and Type," www.fbi.gov/services/cjis/nics

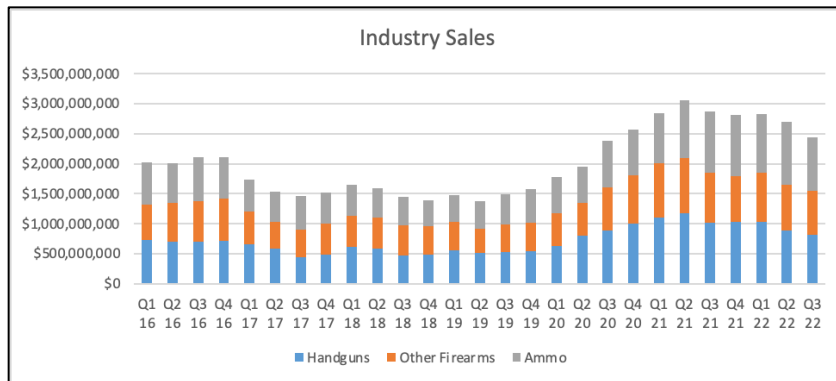
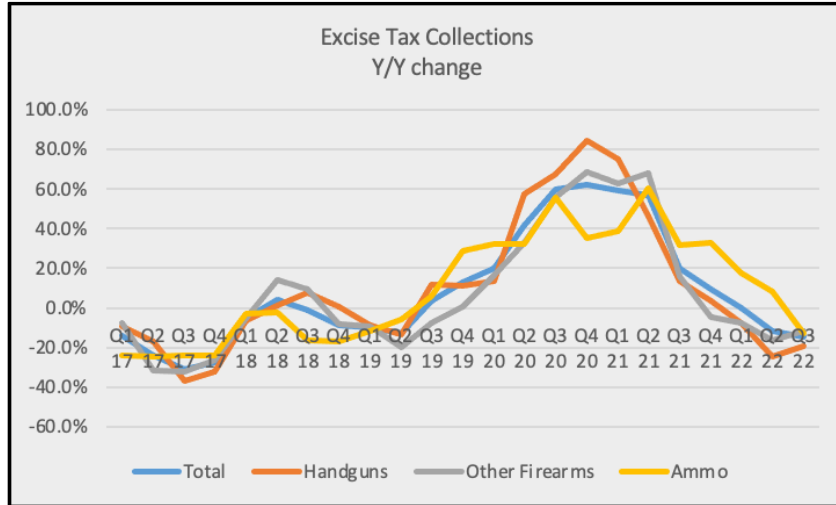
In our view, fear of additional regulations is a key driver of firearm demand. At the federal level, Republican control of the House of Representatives after the election and the current makeup of the Supreme Court suggests little movement on additional firearm regulations. At the state level, crime has become a major issue in many states and we believe this will also inhibit additional firearm regulations. The election could result in a better environment for companies serving the public law enforcement markets (Axon, Digital Ally, ShotSpotter, VirTra and Wrap Technologies) and a less positive environment for the companies serving the consumer market (American Outdoor Brands, Ammo, Inc., Byrna, Smith & Wesson Brands, Sturm, Ruger & Company, Inc.).

From 1999 through 2008, background checks (less permits and renewals) increased at a 1.3% compound annual rate. From 2008 through 2016, checks grew at a 7.3% compound annual rate. From the end of 2016 through 2019, the number of checks fell at a 5.8% annual rate. For 2020, background checks (excluding permits and renewals) were 21.1 million, 60% higher than the 13.2 million checks processed in 2019. In 2021, adjusted checks were 18.5 million, down 12% versus the adjusted checks in 2020 and down from the peak level of a 22.0 million annualized rate achieved in January 2021.



Source: "NICS Firearm Background Checks: Month and Year by State and Type," www.fbi.gov/services/cjis/nics

The increase in adjusted NICS checks as a proxy for firearm and ammunition sales is verified by excise tax data. Using U.S. Treasury Alcohol and Tobacco Tax and Trade Bureau excise tax collection data, wholesale firearm and ammunition sales grew at a 7.2% compound annual rate from 2000 through 2008, 12% from 2008 to 2016 and fell at a 10% compound rate from 2016 through mid-2019. Growth in total excise taxes peaked in Q4 2020 at 63% and have fallen subsequently. Firearm and ammunition excise taxes in Q3 2022 fell 15.0% from the year-ago quarter. Handgun sales declined 19.4%, other firearms fell 11.2% and ammunition sales dropped 13.0%.



Source U.S. Treasury, Alcohol and Tobacco Tax and Trade Bureau, <https://www.tb.gov/foia/electronic-reading-room>.

The tables below present adjusted NICS checks by state and territory for the three months ending in November. For the three months ending in November adjusted checks in the U.S. and its territories was down 7% with gains in very few states, most notably, Oregon and Maryland.

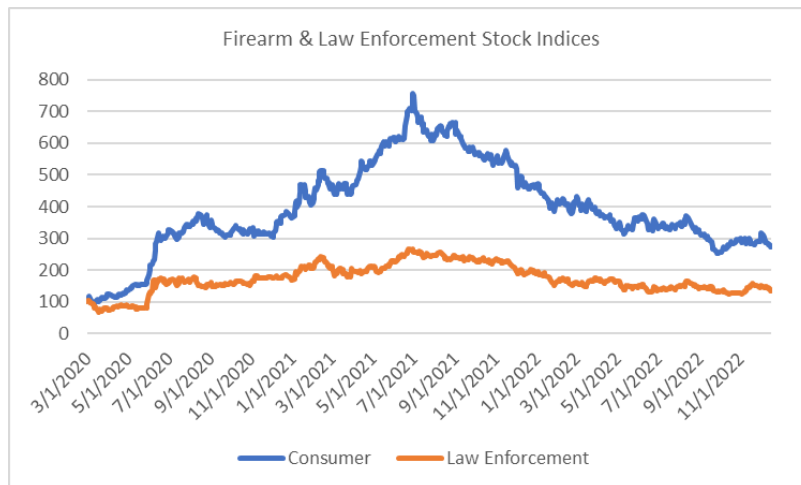
NICS Background Checks (excluding new and renewal permits)
by State and Territory

State/Territory	3 Mos. Ending Nov. 2021	3 Mos. Ending Nov. 2022	Change	Percent Change	State/Territory	3 Mos. Ending Nov. 2021	3 Mos. Ending Nov. 2022	Change	Percent Change
Hawaii	2	4	2	100%	South Carolina	69,868	63,750	(6,118)	-9%
Oregon	84,709	141,169	56,460	67%	Maine	32,446	29,576	(2,870)	-9%
Maryland	45,923	55,771	9,848	21%	Pennsylvania	223,814	203,735	(20,079)	-9%
District of Columbia	1,461	1,710	249	17%	Kansas	47,158	42,886	(4,272)	-9%
Alaska	21,042	23,113	2,071	10%	Kentucky	82,385	74,751	(7,634)	-9%
Georgia	100,351	105,688	5,337	5%	South Dakota	24,048	21,782	(2,266)	-9%
New Jersey	42,598	42,635	37	0%	Colorado	117,806	106,680	(11,126)	-9%
Iowa	21,244	21,177	(67)	0%	Louisiana	86,122	77,966	(8,156)	-9%
North Dakota	18,132	17,641	(491)	-3%	Nevada	29,623	26,791	(2,832)	-10%
New Hampshire	31,017	29,938	(1,079)	-3%	Minnesota	91,062	82,243	(8,819)	-10%
Ohio	144,637	139,085	(5,552)	-4%	Florida	314,526	283,437	(31,089)	-10%
Arkansas	56,533	54,162	(2,371)	-4%	California	260,031	233,788	(26,243)	-10%
Vermont	11,976	11,383	(593)	-5%	Massachusetts	32,789	29,352	(3,437)	-10%
Indiana	127,980	121,203	(6,777)	-5%	North Carolina	73,677	65,893	(7,784)	-11%
Alabama	128,679	121,605	(7,074)	-5%	Puerto Rico	20,140	17,951	(2,189)	-11%
Missouri	137,372	129,394	(7,978)	-6%	Wyoming	17,977	15,967	(2,010)	-11%
Illinois	114,524	107,821	(6,703)	-6%	Idaho	46,193	40,965	(5,228)	-11%
West Virginia	46,808	44,060	(2,748)	-6%	Texas	385,506	340,454	(45,052)	-12%
Tennessee	159,308	149,345	(9,963)	-6%	Connecticut	30,376	26,673	(3,703)	-12%
Virginia	147,635	138,332	(9,303)	-6%	Nebraska	8,391	7,272	(1,119)	-13%
Utah	38,222	35,738	(2,484)	-6%	Michigan	149,508	128,575	(20,933)	-14%
Totals	4,321,396	4,028,522	(292,874)	-7%	New York	96,797	80,759	(16,038)	-17%
Oklahoma	90,161	84,021	(6,140)	-7%	Rhode Island	7,557	6,238	(1,319)	-17%
Mississippi	68,163	63,204	(4,959)	-7%	Guam	1,181	959	(222)	-19%
New Mexico	41,221	38,132	(3,089)	-7%	Washington	122,294	97,876	(24,418)	-20%
Wisconsin	117,749	108,348	(9,401)	-8%	Virgin Islands	169	128	(41)	-24%
Arizona	102,016	93,659	(8,357)	-8%	Mariana Islands	125	93	(32)	-26%
Montana	36,475	33,382	(3,093)	-8%	Delaware	13,889	10,262	(3,627)	-26%

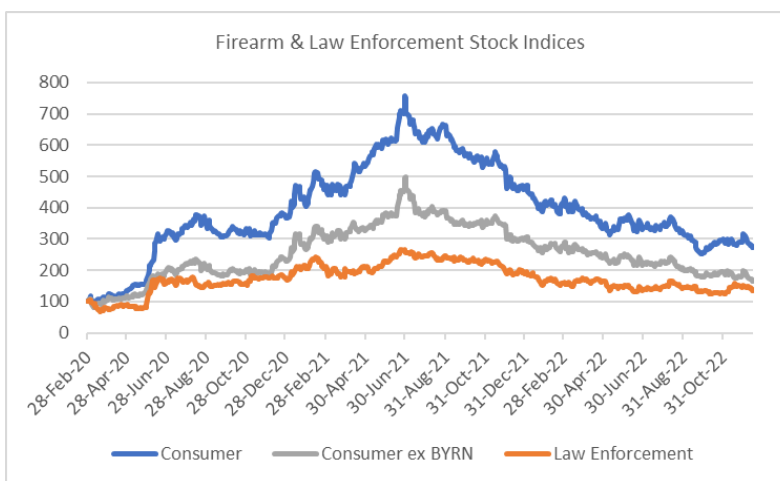
Source: "NICS Firearm Background Checks: Month and Year by State and Type,"
www.fbi.gov/services/cjis/nics

We have created two indices to capture the share performance of firearm/self-defense and accessory companies primarily serving 1) the consumer market: American Outdoor Brands, Ammo, Inc., Byrna, Smith & Wesson Brands, Sturm, Ruger & Company, Inc. and 2) those primarily serving the law enforcement market: Axon, Digital Ally, ShotSpotter, VirTra and Wrap Technologies.

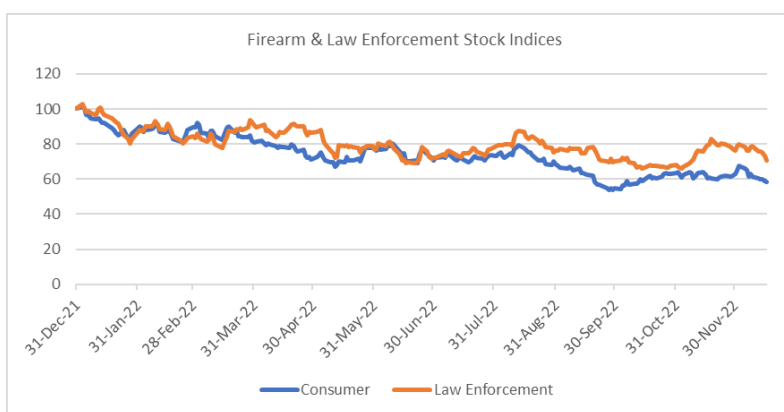
The indices are equal-weighted, chain-linked and begin in March of 2020, about the start of the pandemic. From March 2020 to their respective peaks in June 2021 the consumer index increased over 640%, much of the increase due to the increase in Byrna. Excluding Byrna from the group, the consumer index would have increased over 380%. The law enforcement index increased 167%. The index of the consumer group has declined 64% since its peak versus a 50% decline for the law enforcement index from its peak. Year-to-date, the consumer index is down 42% and the law enforcement index is down 29%.



Source: FactSet



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Broadly speaking, the declines in the share prices of the group has been in line with the declines in revenue and EBITDA estimates. The table below presents the group and changes in consensus revenue estimates for calendar 2022, from the beginning of the year to today, and calendar 2023 from the middle of the year to today. For 2022 the median decline in sales estimates was 20% and the median decline in EBITDA estimates was 36%.

Estimates for 2023 have declined, but still assume a resumption of growth which could be optimistic given current conditions.

Stock Price Performance of Components of Firearm and Law Enforcement Stock Indices

	YTD Stock Change	Change in 2022 Revenue Estimates (Jan-Dec.)	Change in 2023 Revenue Estimates (June-Dec.)
Consumer	-41.6%		
Sturm, Ruger & Company, Inc. (RGR)	-12.6%	-7%	-7%
Byrna Technologies Inc. (BYRN)	-34.5%	-21%	-23%
American Outdoor Brands, Inc. (AOUT)	-50.5%	-25%	-21%
Smith & Wesson Brands, Inc. (SWBI)	-50.8%	-26%	-27%
AMMO Inc (POWW)	-66.8%	-20%	-23%
Law Enforcement	-29.2%		
ShotSpotter, Inc. (SSTI)	18.5%	14%	0%
Axon Enterprise Inc (AXON)	7.9%	15%	9%
VirTra, Inc. (VTSI)	-40.7%	-1%	-6%
Wrap Technologies, Inc. (WRAP)	-47.1%	-52%	-13%
Digital Ally, Inc. (DGLY)	-76.6%	-21%	-19%

Source: FactSet

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Current as of 7-Dec-22

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Ratings Distribution	# of Companies	% of Total	# of Companies	% of Totals
Market Outperform (Buy)	23	77%	2	9%
Market Perform (Neutral)	6	20%	0	0%
Market Underperform (Sell)	1	3%	0	0%
Total	30	100%	2	7%

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