



Conference Call Transcript

GMTN - Q4 2004 GANDER MOUNTAIN CO Earnings Conference Call

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PRESENTATION

Operator

Good morning, everyone, and welcome to the Gander Mountain Company fourth quarter earnings release conference call. This call is being recorded. At this time I would like to turn the call over to Senior Vice President of Finance and Administration, Ms. Sharon Link. Please go ahead, Ms. Link.

Sharon Link - Gander Mountain Company - VP Finance & Administration

Thanks, Michele. Good morning. Welcome to the Gander Mountain fourth quarter and year-end conference call. Joining us on our call today are Mark Baker, President and CEO of Gander Mountain, Dennis Lindahl, Executive VP and CFO, and Al Dittrich, Executive Vice President of Merchandise. Mark will offer his comments to begin, Al will discuss merchandise trends and expansion of our product assortment and Dennis will review our financial results. We will take your questions after that. We expect the call to last an hour.

As a reminder the question and answer session is available to all interested parties, although questions will be limited to investors and analysts. We also remind you that the media is attending the call in a listen-only mode. This conference call is being broadcast real-time on the Internet at www.gandermountain.com. We will also offer a Internet replay of the call which will be available shortly after the call is concluded and will remain on our website for approximately 90 days. The transcript of this call will be posted under the Archive section in the Investor Relations section of our website.

Let me caution you that our discussion today may include forward-looking statements relating to our estimates and expectations that involve risks and uncertainties. Our actual results could differ materially from those projected in any forward-looking statements. Additional information concerning important factors that can cause our actual results to differ materially from those forward-looking statements are described in the risk factor section of the final prospectus relating to our initial public offering as filed with the SEC as well as in our subsequent reports filed with the SEC. These reports are available at the Investor Relations section of our website and at the SEC's website at www.sec.gov. We caution you that forward-looking statements reflect our current views with respect to future events and speak only as of the time they are made and our actual results may differ materially from the present expectations or projections. Given these uncertainties you should not place undue reliance on these forward-looking statements and we undertake no obligation to update them in light of new information or future events.

Before turning the call over to Mark, I would like to comment on the class action lawsuits and shareholder derivative lawsuit that have been filed against us. We believe these lawsuits are completely without merit and will defend ourselves vigorously against them. However, we will not comment further on pending legal actions and will not take questions on this topic. I will now turn the call over to Mark.

Mark Baker - Gander Mountain Company - President & CEO

Thanks, Sharon. Good morning and welcome to Gander Mountain's fourth quarter earnings call. I would like to welcome all of our shareholder, analysts and all the participants. As you know Gander Mountain is a leader in outdoor life style retailing today, with 82 stores and sales over \$640

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million in 2004. I just want to remind you one more time about the type of specialty retailer that Gander Mountain is. We are in the outdoor lifestyle sector, not a traditional sporting goods retailer. Our products appeal to everyone who enjoys participating in the outdoors, whether through hunting, fishing, hiking, boating, kayaking, camping or just backyard grilling. We offer depth and breadth of assortment in value-oriented retailing in a big box. We are growing rapidly through our store expansion and taking advantage of the fragmented nature of this retail sector.

Today's sales increased over 30 percent in the fourth quarter, reflecting the 19 new stores opened last year including 2 relocations. We plan to open additional 18 to 20 stores this year. We are the largest retailer in the outdoor lifestyle segment, more stores than the next 3 competitors combined in the under-served outdoor lifestyle market. 2004 was a challenging year. Our performance was not what we hoped. We did not achieve our expectations or yours. The third and fourth quarter, in which we generate over 65 percent of our sales and all of our profit, presented significant challenges. The unfavorable trends we discussed in the third quarter call did continue through the fourth quarter, though the weather finally got good and cold in mid and late December. In terms of the fourth quarter sales, the level of sales declined across the board, impacting both comp stores and new stores.

One positive about the weather was we did finally get the hard freeze our customers needed to allow ice fishing over the holidays. But it was too late for all the fall hunting seasons, which were essentially over by this point in time. Clothing sales in January helped our sales numbers but hurt the margins. However we did achieve an expansion in our operating profit rate of 60 basis points in the quarter. And pretax increased 42 percent despite the declining comparable store sales as we successfully managed our expenses. Even with negative comps, the core base of smaller stores were more profitable in the fourth quarter of this year than they were last year. We are carefully managing our inventory in the face of these lower sales and inventory per square foot declined.

2004 was also a significant year of accomplishments for Gander Mountain and a number of initiatives that were begun in 2004 to lay the groundwork for 2005 and beyond. For the year, we successfully completed our initial public offering, raising over \$105 million of equity funding to continue our growth. We negotiated an expansion of our extension of our credit line with the Fleet Group. In February we signed the new agreement increasing our line to \$225 million, which may be increased to \$300 million subject to certain terms and conditions. We anticipate this financing to be sufficient to fund our 2005 growth. We added 19 new stores, including 2 relocations, introducing Gander Mountain to enthusiastic customers in 5 new states, Virginia, Kentucky, Colorado, North Dakota and Texas, which as all of you know we've talked about Texas as one of the great retail markets in the country for hunting. We are pleased with our new stores' performance, as our Houston was one of our top performers of the fourth quarter.

We continue to add to the depth and experience of our leadership to support the growth and added technology to meet the needs of our projected growth while keeping our costs under control. In 2004 our first big box stores entered the comp sales base. We are using the history we accumulate to better understand how sales and margins of those stores ramp up, their seasonality, the way they cycle the first 12 to 24 months. We find that the first year of comp store sales of these are impacted significantly by the grand opening effect. We are now incorporating this knowledge into our projections for performance of the new stores in their second years, realizing that they do not settle in the normalize sales pattern until they have comped each opening season.

We found the cannibalization and competition had impacted more than we anticipated. As an example, in the Twin Cities, where we have 2 big-box stores we have seen more continued cannibalization of our smaller stores than we anticipated. In 2004 we felt some competitive pressure. We've said before our big box stores hold our customers better than our small stores. We are comfortable in facing competition from the entertainment style retailers as well as going into markets where our primary competition is mom and pops. We approach our customers differently from our entertainment-style retail competitors. We believe that we offer the customer the best value proposition in the outdoor life style business. We focus on offering our customers value pricing. We believe the customer is recognizing the value and the assortment we offer. Our strengthened marketing program reinforces this differentiator.

We provide value to our customers through our store extensive assortment of goods. We have the flexibility to tailor the assortment to local preferences and adaptability to expand the products and services we offer to meet the growing needs and demands of our customers. We have value-added through our professional services that we provide. As an example, we are the largest employer of professional gunsmiths in the country. We provide convenient extra service at every one of our locations. Our enthusiastic and talented employees are committed to outstanding customer service and profitable growth. As experts in the outdoor activities our customers enjoy, our associates provide valuable advice to our consumers. And now Al Dittrich, EVP of Merchandising will give you an update on some of the product trends in the fourth quarter and talk about the expansion of our marine service. Al.

Al Dittrich - Gander Mountain Company - EVP Merchandising

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Thank you, Mark, and good morning, everyone. Overall our product gross margin for the fourth quarter improved by 20 basis points excluding the positive impact of re-classifying vendor co-op. We achieved sales and margin rate improvement in many categories, even though we had negative comps for cold weather, fieldwear, cold weather apparel, accessories and footwear. Strong categories in the quarter included archery, gun safes, new and used firearms and our ATV power shop. We proactively managed inventory, ending the quarter with reduced inventory per square foot in the face of the challenging sales. On a full year basis in 2004 we increased our product gross margin by 40 basis points after excluding the positive impact of re-classifying vendor co-op.

We are continuing our margin improvement strategies in '05. Our growth gives us scale and leverage with our current suppliers, allowing more efficient buying, and allows us to source more products directly. We recently expanded our owned brand and direct sourcing team, which will strengthen our mix of direct-sourced product in the important third and fourth quarters. As you know, one of the challenges we face is the seasonality of our business, which is heavily skewed to the third and fourth quarter. We continue to seek additional opportunities to build our sales base in the first half of the year. As we move into '05, we continue to work our strategies to improve the seasonal balance of our business and produce higher gross margins. Expanding our selection of marine products is one of those opportunities. As we indicated in our third quarter call, the marine accessories sets being implemented into our new stores now include products such as replacement products like boat seats, line and anchors; mandatory safety equipment required by the Coast Guard -- life preservers flares, fire extinguishers, horns; electronics, including navigational equipment, GPS, fish finding devices, sonar, stereos and speakers; oil, lubricants, cleaning products, and other maintenance products; as well as fun inflatables, towables and kneeboards -- and in select stores, Yamaha boat motors. We are increasing the amount of floor space dedicated to the category. We are adding several new market-leading brands to the mix. Our initial test store, which set in late January, is producing positive results. Marine products are a logical product line extension for us. Not only do many of our fishing customers have boats but also many of our outdoor enthusiasts enjoy boating of all sorts. We are also expanding our assortment of boats beyond our selection of canoes, kayaks, and small fishing boats. We will expand our small fishing boat assortment in all stores.

We've also announced that we are partnering with Genmar, one of the world's premiere manufacturers of fishing and recreational boats. We are testing the sale of larger fishing and recreational boats in seven of our stores. We are currently carrying three lines of boats that appeal to both fishermen and recreational boater, with each store generally carrying two of the lines. The boats include Stratos and Champion, 17- to 21-foot fishing boats, and Seaswirl, 17- to 23-foot family boats including runabouts, deck boats, bow-riders and multipurpose fish and ski boats. Prices on these boats range from \$16,000 to \$44,000. We accept customer trade-ins. We offer retail financing and service, which is leveraging our existing ATV power shop centers. We will also be offering boat rental in select stores, again through a partnership with Genmar.

Boat rental will allow our broad base of customers to enjoy the outdoors and opportunity to experience boating. While they may not want to make the commitment to own a boat, they can enjoy use of a boat whether for vacation or just for a day. We are excited about the opportunity to offer our customer a broader selection of products for the outdoors. We continue to fine-tune all of our assortments to best meet the needs of our customers. The merchandise mix in any one of our stores is tailored to the wants and needs of that store's local customer. We work closely with the local hunting, fishing and outdoor non-profit organizations well in advance of a store opening. In some cases we've hired local merchants to help us understand specific markets. On an ongoing basis, the local experts we have in our store staffs continue to help us fine-tune the 38,000 SKUs in each of our big box locations. In addition, we provide our customers with access to hundreds of thousands of additional SKUs through our special order program. Now I will turn it over to Dennis Lindahl, our CFO, who will go into more details on the financials.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Thanks, Al, and good morning, everyone. I am going to assume that you've seen our press release and don't need me to read all the numbers so I can use this time to discuss some of the drivers behind the financials. But first, a brief review of the lease accounting issue. As discussed in our press release dated March 9, 2005, we were required to restate our previously issued financial statements to adjust for our method of accounting for leases. Financial statements issued earlier today in conjunction with our press release include the revised adjusted accounting for leases. You should note that the cumulative pretax adjustment for all years prior to fiscal 2003 was \$5.3 million. The adjustment for fiscal 2003 was \$803,000 and the adjustment for the first 3 quarters of fiscal 2004 was \$1.6 million.

The change in accounting had no material impact on the fourth quarter of fiscal 2004. As shown on the income statement a substantial portion of the adjustment related to preopening rent expense -- \$1.024 million in fiscal 2003 and \$1.780 million in the first three quarters of fiscal 2004. This results from the Company now beginning the lease term on the earlier of the commencement date of the lease, the date when the Company takes possession of the building for construction of leasehold improvements, or the date we initiate the initial set up of fixtures and merchandise. This compares to our previous practice of beginning the lease for accounting purposes on the commencement date of the lease. Obviously, as a high-growth Company that opens a significant number of new stores and that utilizes recycled real estate that reduce lease rates and does some of

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our own tenant improvements, we are significantly more impacted by this change than many other retailers. To the extent that we continue to utilize recycled real estate and manage the tenant improvement work ourselves, we will continue to have significant preopening rent expense.

These restatements have no impact on the Company's future sales or cash flows. However, they do impact our balance sheet, as construction allowances will now be classified as deferred rent credits and no longer recorded as reductions of leasehold improvement costs. I will discuss that balance sheet impact in more detail later in the call. All of the rest of my comments today will be based on fiscal 2004 and 2003 financial information that reflects the lease accounting adjustments. In the fourth quarter, revenue increased 30 percent as a result of new store growth. Comparable store sales declined 5.4 percent in the quarter on top of a 12.2 percent gain in the 2003 quarter and a 12.0 percent gain in the fourth quarter of 2002. In the fourth quarter, four stores that opened in the fall of 2003 entered the comp store base, bringing the total number of 2003 stores in the comp store base to nine, including eight big-box stores.

Pretax income for the fourth quarter increased 42 percent to \$17.6 million from \$12.4 million from the 2003 quarter. For the full year, sales increased 31 percent on new store openings and a comparable store sales decline of 2.5 percent. Last year's comp store sales increase was 11.5 percent. Pretax income was approximately \$0.75 million for each year. Before I go into details, let me comment overall on the change in vendor contracts for the last time. Under the system in effect last year, vendor co-op funds resulted in a reduction in store-level advertising expense as they were received. Earlier this year, Gander Mountain worked with its vendors to eliminate proof-of-performance on substantially all of its contracts. Therefore when we purchased from these vendors today, associated vendor co-op funds go onto our balance sheet until we sell the product, at which time they are accounted for as a reduction in cost of goods sold.

There are two results of this change, recognition of the benefits as deferred as compared with the prior year, and in addition, both gross margin and store operating expenses are affected by classification of these vendor-related items. Vendor co-op funds are now accounted for as a reduction in cost of goods sold, thus positively impacting the gross margin. Previously they had been accounted for as an offset to advertising expense, so the change has a negative impact on the operating expense rate. I will discuss the actual impact later. Turning to store productivity metrics, total square footage at the end of the fourth quarter increased 49 percent from last year to 3.8 million square feet. We did not open any new stores in the fourth quarter of 2004, but we opened one new store in the fourth quarter of 2003. The average square footage per store was 46,000 compared with 39,000 square feet last year. Our average store size will continue to increase. We expect most new stores to be in the 60- to 65,000-square-foot range, but we will continue to size our new stores appropriately for each market.

Customer transactions totaled 4.2 million for the quarter compared to 3.6 million last year. Transactions were down about 11 percent in the comp stores. Our average customer ticket increased over 11 percent from \$51 to \$57 for the quarter. The average ticket at our comp stores increased about seven percent in the quarter. The average ticket at our larger stores is more than \$10 higher than at our smaller stores, and the ATVs and other power shop items account for only about \$1 of that higher average ticket. For the full year, the average ticket increased from \$50 to \$53, again with a higher average ticket in our larger stores. Sales per square foot for fiscal 2004 was \$205 versus \$226 last year as a result of the decline in comparable store sales and the impact of lower sales per square foot in our less-mature new stores.

Gross margin improved 50 basis points in the fourth quarter. Major factors contributing to the improvement were that we had a 20-basis-point improvement in product margin despite a more promotional environment in the post holiday period that negatively impacted the margin by 40 basis points. We continue to pursue gross margin initiatives to increase sales of apparel and footwear, expand our owned brand, expand direct sourcing activities and leverage increased volume and vendor support. We have yet to see the increased penetration we anticipated in apparel and footwear due to the negative comps in our cold weather fieldwear, apparel, accessories and footwear categories. However, are excited about the product lines we are presenting to our customers and anticipate that apparel and footwear penetration will increase. Our owned brand product achieved a 350-basis-point improvement in margin as we moved to more direct purchasing. We expect our owned brand penetration to increase as we build our brand.

Change in the vendor contracts mentioned earlier increased the gross margin rate by 110 basis points for the fourth quarter. At the end of the year we still had \$3.8 million of vendor co-op on the balance sheet that will come into gross margin as we sell the associated product. Partially offsetting these improvements were store occupancy costs, which increased 40 basis points as a percent of sales as a result of de-leverage on lower than expected sales, and higher transportation costs. For the full year, gross margin increased 100 basis points. A major factor behind the increase was the change in vendor contracts, 100 basis points, as other improvements in product margin were substantially offset by the increase in store occupancy costs as a result of lower sales per square foot in 2004 versus 2003.

Turning to expenses. Store operating expenses as a percent of sales for the quarter increased 50 basis points to 15.7 percent from 15.2 percent last year. The change for vendor co-op funds that I mentioned earlier caused an 80-basis-point increase in expense. Payroll expense as a percent of sales increased 40 basis points, as we were unable to reduce our expenses in line with the sales shortfall. But these increases were offset in part by a reduction in advertising as a percent of sales of 60 basis points as we reduced our brand marketing in the fourth quarter. For the full year, store

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operating expenses as a percent of sales increased by 130 basis points to 18.9 percent from 17.6 percent, substantially as a result of the change in vendor contracts. Other expenses were in line with the prior year on an overall basis. General and administrative expenses for the quarter were 2.7 percent of sales compared to 3.0 percent last year. Among the factors impacting these expenses were the absence of bonuses, the change of our vacation policy last year and gift card breakage. For the year general and administrative expenses were 4.0 percent of sales in fiscal 2004 versus 4.4 percent in 2003.

Pre-opening expenses for the year with the new accounting for leases were \$9.1 million versus \$5.7 million the prior year. We opened 19 stores in fiscal 2004 up from 10 last year. Net interest expense was 1.5 million for the fourth quarter this year versus \$1.3 million in the comparable quarter last year. For the full year, interest expense was \$5.1 million versus \$4.8 million in 2003. No income taxes were recorded in 2004 as the Company was able to utilize its loss carry forward. GAAP EPS was \$1.21 on a fully diluted basis for the quarter against \$8.48 per share in the prior year. On a fully diluted pro forma basis, the GAAP income per share in the fourth quarter was \$1.21 compared to \$0.91 in the prior year. Weighted-average number of shares for the quarter on a fully diluted basis was 14.5 million, both under GAAP and on a pro forma basis. Under the treasury stock method the number of shares used to calculate earnings per share varies depending on the number of option shares outstanding and the market price of the shares.

On the balance sheet, inventory per square foot in open stores was \$69, down two percent from the prior year, inventory turnover was 1.7 times for the year compared with 2.0 times last year. Overall the change in lease accounting impacted property and equipment, long-term liabilities, and shareholders equity on the 2003 balance sheet. Property and equipment decreased by \$1.4 million from the previously reported amount, primarily due to the shorter amortization lives for tenant improvements. Long-term liabilities increased \$4.7 million as a result of recording additional straight-line rent for the periods of time prior to lease commencement date. Shareholders equity decreased \$6.1 million related to the cumulative effect of the change in accounting for leases. Capital expenditures requiring cash were \$44 million in 2004, including \$10.3 million funded by tenant improvement allowances, versus \$21.5 million last year primarily for new store openings. An additional \$11.7 million was funded through capital leases, primarily one store location with a bargain purchase option. Long-term liabilities increased \$14.4 million in fiscal 2004, reflecting the tenant improvement in capital lease amounts discussed above and the normal straight-line rent accruals each year and a repayment of \$9.7 million of long-term debt.

Now turning to our store performance. The contribution, as Mark indicated, from our smaller stores was greater in 2004 than in 2003 despite declining comps. Sales and margin performance for our 2003 and 2004 new stores was somewhat below our expectations. On the other hand, we believe that the absolute sales levels that we did achieve provide us the opportunity to improve our performance in these stores over time. We continue to lower the opening inventory level for new stores and to more effectively staff the stores for the anticipated sales levels. The results from the 2004 new stores indicate that they outperformed the 2003 new stores during those stores' first year of operation by a meaningful amount. In summary we believe we will achieve our overall Company operating margin goal of 5 to 6 percent over time.

For 2005, we anticipate that sales will increase to at least \$850 million, driven by new stores and an increase in comparable store sales of at least 2 percent. We project that pretax income will be at least \$16 million. This estimate includes the adoption of Financial Accounting Standards Board statement number 123 R related to accounting for options. We have accelerated the vesting of all options that were out of the money on March 3, 2005, a total of options for 1.2 million shares. These options are generally exercisable at \$16 per share. We anticipate adding 18 to 20 new stores including two or three relocations. Most of those stores will be 60- to 65,000 square feet and we expect all will have outdoor selling areas. Most of these new stores will continue to reinforce the Company's penetration of its current markets, including markets the Company entered in 2004 such as Texas and Colorado. The others will be in new markets contiguous to the Company's current market.

We are currently executing the upgrade to our distribution center that will enable the facility to meet our needs until late 2006 or 2007 at a cost of \$2 to \$3 million. In preparation for our move to our new headquarters next week, we expect to terminate most of the shared service arrangements with Holiday Companies. We do not expect this transition to have a meaningful impact on operating costs and it has been factored into our plans along with the other costs associated with the move. The new corporate headquarters is a long-term, low-cost alternative that will support our growth. Capital expenditures should be in the range of \$45 million to \$55 million next year including new store openings, the upgrade of our distribution center and our office relocation, as well as normal and recurring store upgrades. The increase from our previous guidance of \$40 to \$50 million results from not reducing tenant improvements for monies received from landlords under our new accounting practice. Finally, we believe that we have the ability to finance these growth plans for 2005. Now we would be happy to take your questions.

QUESTION AND ANSWER

Operator

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Thank you. The question and answer session will be conducted electronically. [Operator Instructions] We will take our first question from Mitch Kaiser with Piper Jaffray.

Mitch Kaiser - Piper Jaffray - Analyst

Dennis, I was just curious whether you could go through the details of the vendor rebates again. I'm just kidding. Sorry. Sorry. Just wanted to talk a little bit about marine. I had a chance to go up to the Forest Lake store and noticed the boats in there. It's probably a little early, but in terms of categories that that's replacing and what your plans are for accessories and things around that, if you could just comment a little more on that.

Mark Baker - Gander Mountain Company - President & CEO

Mitch, I am going to give that one to Al because he has engineered most of that. Al.

Al Dittrich - Gander Mountain Company - EVP Merchandising

In reference to the space that it replaced, it's a combination of a bit of off-season hunting space, some off-season fieldwear space, and some off-season outerwear space. What you haven't realized at Forest Lake yet is we are adding outside selling to that store as well, and most of our boat stores will have outside selling space to manage some of that inventory as well. Just across the aisle from that you may have noticed that we doubled the space for the marine accessories strategy in that store as well. And we are very pleased with how that marine accessory business has performed for us there.

Mitch Kaiser - Piper Jaffray - Analyst

How many stores do you think will have marine in it in 2005?

Al Dittrich - Gander Mountain Company - EVP Merchandising

In reference to the boats that you saw in Forest Lake?

Mitch Kaiser - Piper Jaffray - Analyst

Yes.

Al Dittrich - Gander Mountain Company - EVP Merchandising

We will have that in seven stores, and then we are opening an eighth store in mid year that we will add boats to as well. The total will be eight as we see it now for '05.

Mark Baker - Gander Mountain Company - President & CEO

And, Mitch, all -- most of the stores will get some marine impact in terms of the accessories and then a number of stores, which we haven't disclosed yet, will all have the boat rental as well.

Mitch Kaiser - Piper Jaffray - Analyst

Okay. Then I will just ask one more and then open it up. In terms of the credit cards, your private label credit card, is there any update there as to where you are at with the program?

Al Dittrich - Gander Mountain Company - EVP Merchandising

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We are going to be finalizing our agreement with MBNA within the next 30 days. We feel that we will be working through that program and then we anticipate we will have a new program open for the fall season.

Mitch Kaiser - Piper Jaffray - Analyst

Okay. Sounds good. Thank you.

Operator

Next we'll move on to Reed Anderson with Friedman Billings Ramsey.

Reed Anderson - Friedman Billings Ramsey - Analyst

I know you don't want to give quarterly guidance and I'm fine with that but could you just give even a little bit of thought on near-term expectations? It would strike me that you are still really more of a second half story this year given the way that '04 unfolded. Is that the case or given like the comps you put up in the fourth quarter do you think you can do a little bit better than that in the first quarter?

Mark Baker - Gander Mountain Company - President & CEO

Reed, I'll just give you the general over time and I'll let Dennis give you kind of what we're willing to talk about here. Obviously, we are a fourth quarter Company. We said we did 65 percent of our business -- I'm sorry, a second half business -- 65 percent of our business in the second half. We will always have a very significant percentage of our business and our profits in the second half. We are working hard, as you know, with this marine endeavor and marine accessories as well as our geographic diversity to build a better front half. Our opportunity in this business is to take the first half and hopefully some day report profits in the second quarter. That's what the opportunity that lie ahead for us. Where we are at in that and how long it takes us to get there? It's going to take us a little bit of time. We are confident we can build a better first half. Dennis?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Reed, I think that over time with diversification to Texas, where we probable have less seasonality in the southern part of the United States, as well as some of these marine and boating areas, we will be able to do that. But certainly in 2005 we don't see any significant change in the seasonality of our sales or income from 2004.

Reed Anderson - Friedman Billings Ramsey - Analyst

Given what you've got going on from an initiative standpoint, is it fair to say that you maybe having a little bit disproportionately more spending in the first half this year than you might have last year?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

I think there's some truth to that. But, also just if you look we also have 19 additional stores and to the extent that stores are not very profitable in the first half of the year because of that, the more stores you have there is the potential that you lose more money in the first half of the year than you would have the prior year.

Reed Anderson - Friedman Billings Ramsey - Analyst

Okay and then another question is, and you may have commented on this but I missed it, and if that's the case I apologize. Just give us an update on what's going on from an advertising standpoint? I seem to either get more things in the mail or see more things in the paper. I'm not sure what it is, has that changed at all or what sort of your thought process there versus what it might have been 6 or 12 months ago?

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Mark Baker - Gander Mountain Company - President & CEO

Reed, we've hired a new fellow by the name of Curt Avellone as our Senior Vice President of marketing. We think we are evolving to a more targeted marketing program over time and fortunately you are targeted so you get more stuff. And we think that that's going to pay off for us in the future and keep our costs low. We are continuing to evolve and test response to those programs.

Reed Anderson - Friedman Billings Ramsey - Analyst

One last one, just kind of a general comment question. I mean, a lot of things happened last year that -- things out of your control. And what have you done -- what assurances can you give us today, the things that you -- processes or whatever that you put in place that maybe you've improved your forecasting precision. You comment a little about that but -- Dennis, say, you can give us some thoughts on how things are -- you feel that your visibility is a little bit better today than it might have been 6 or 12 months ago?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Reed, I think that we have pretty much the same type of visibility. Whenever you have opening 19 stores and you have 65 percent of your sales in the second half and you are at the -- and you have the world out there with the economy and weather and everything else, competition, it's a little bit hard for us in January to be able to really define within a very small narrow band what we think our performance will be. You will note that this year all of our guidance was we have an expectation that we will exceed the \$16 million, the 2 percent comps and whatever. We have visibility out there and obviously we have expectations to outperform those. I don't think anything has changed necessarily in our ability to forecast. We still have -- we still have the reasonable ability but I don't see any differences.

Mark Baker - Gander Mountain Company - President & CEO

I think, Reed, the only thing that I would add to that is that we do have the visibility to us about markets that weren't as effected by weather or competition or cannibalization, so that we in a steady state can have a better idea about what our real performance was and gives us some confidence about where we will be in 2005.

Reed Anderson - Friedman Billings Ramsey - Analyst

Good. Well, good luck.

Mark Baker - Gander Mountain Company - President & CEO

Thank you.

Operator

Next we move on to Kevin Foll with Next Generation Equity.

Kevin Foll - Next Generation Equity - Analyst

A couple of questions for you. On the direct sourcing initiative that you are working on, seems like that's delivering some upside to margins. What level of direct sourcing were you at in '04 and what's the potential a couple of years from now and where do you see the merchandise margins going as a result of that?

Al Dittrich - Gander Mountain Company - EVP Merchandising

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We haven't commented on the absolute level of direct sourcing and so what I can tell you is that we have added to that team and our size and scale has allowed us to get into categories that in the past we haven't been able to get into as effectively. We see that continuing to increase and our efficiencies overseas are getting better and better. We will continue to add categories that we will be able to direct source which can help our margin. And in some of the things that we were already direct sourcing we feel that we can source those a bit better than we have been in the past.

Mark Baker - Gander Mountain Company - President & CEO

Just to help you a little bit further, then, Kevin, this initiative is really only about 12 to 18 months old. And we see a lot of opportunity over the next number of years. As you know it takes a season or two in cycling and lead times on these products or a little longer, but we see it as a long-term opportunity.

Kevin Foll - Next Generation Equity - Analyst

Great. Thanks. And any promotional changes then in the first half of this year and I guess follow-up to that, do you see an impact from the credit card, the elimination of the credit card program impacting the first half of the year a little bit.

Mark Baker - Gander Mountain Company - President & CEO

Promotional changes, assuming that we're not going to telegraph to our competitors exactly what we are doing, we feel pretty confident about our level of promotion and customer contact. We've got some exciting things that we are pretty excited to look forward to as we open into the -- the beginning of fishing seasons, the marine seasons, the camping seasons, that we think we've got some targeted attempts to get our customers in our stores. We feel very comfortable with that. From the credit card point of view, as Al mentioned, we are putting plans in place to evolve away from MBNA and into a new program. And I think we are comfortable with where we are at with the credit card conversion and the time that it will take us through that in the first half of this year. And when you relaunch, that is that going -- is there going to be a discount attached to signing up for that as well? You know I can't tell you that. We will be very competitive in our offer for serving our customers in terms of how they need to be financed or how they need to be rewarded.

Kevin Foll - Next Generation Equity - Analyst

Last couple of questions. Any guidance on interest expense for '05 given the new revolver situation.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

There is really no impact on our interest rate as a result of that. I would guess that obviously our interest expense would be substantially higher than it was in 2004. But there's no rate change as a result of that.

Kevin Foll - Next Generation Equity - Analyst

Okay. Thank you.

Operator

Next we will move on to Robbie Ohmes with Banc of America Securities.

Ben Rosen - Banc of America Securities - Analyst

Thanks, this is actually Ben Rosen for Robbie Ohmes. Two quick questions. First on the store opening timeline, are you still planning on that kind of 8 to 10 in the spring and then the balance in the second half much.

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Mark Baker - Gander Mountain Company - President & CEO

Ben, we've got, I think, eight up on our website right now that show their openings for the first half of this year and those are all on track. And we haven't given exact locations and timing for the back half. It would appear to be about that.

Ben Rosen - Banc of America Securities - Analyst

And then, kind of similar to what was asked before related to your guidance for a comp increase of at least two percent, is that where you are running to-date in the current quarter or can you comment at that at all? And then along the same lines your inventory position, how fresh is that in terms of, have you gotten through a lot of the clearance from the fourth quarter? And is there a lot of overhang into the first quarter or the first half that you see?

Mark Baker - Gander Mountain Company - President & CEO

Ben, as you might guess, we're not going to comment about the quarter and where we are at in the comparable levels. But we have given that guidance that is built on our looking at the full year and where we believe we can do, at least that good, for the full year on comps. On the inventory position, Al and his team and obviously we reflected it in our margins in January. We are very aggressive about not carrying over products that won't sell. We want to make space in our stores with fresh inventory and continue to make sure that we don't sit on products that don't sell and get cleaned up at the end of the seasons., painful as it may be. But one of the best lessons I can give you in retailing is never hang on to something that you think is going to be better tomorrow. We're very -- give merchants a lot of credit for that discipline.

Ben Rosen - Banc of America Securities - Analyst

Okay, great. I guess just one more, where did you end up in terms of private label at the end of the year.

Mark Baker - Gander Mountain Company - President & CEO

Al, maybe you can comment where we are on private label and our growth in that.

Al Dittrich - Gander Mountain Company - EVP Merchandising

Our owned brand penetration did not increase as much as we wanted it to increase, mostly because a lot of that is in our cold weather accessories, fieldwear and outerwear. So as that business had negative comps, we weren't able to grow that penetration as much as we wanted to.

Mark Baker - Gander Mountain Company - President & CEO

We were at that 7, 8 percent. We can see huge opportunities and Al's got a team in place to better source that product and we see growth in that over time.

Ben Rosen - Banc of America Securities - Analyst

Okay, thank you.

Operator

John Zolidis with Buckingham Research will have our next question.

John Zolidis - Buckingham Research - Analyst

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A couple of questions. I just wonder if you would talk about the sales productivity in a per square foot basis at the new larger-size stores as compared to the smaller-size stores, and whether or not you think that the larger stores can eventually reach the same level of sales per square foot that you see at the smaller stores? And then related to that, what kind of return on investment are you expecting at the larger stores versus the smaller stores? And then, one additional question, which is how should we think about taxes for next year? Are you going to be paying taxes? Thank you.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Let me start with sales per square foot at the larger stores versus the smaller stores. Over time, we believe that we would be able to get the same kind of sales a square foot and productivity on the larger stores versus the smaller stores. Obviously our absolute numbers at this point in time are somewhat -- somewhat less, and once we get these larger stores to maturity we expect them to be at the same level as the smaller stores. As it relate -- currently, obviously, they are not at those levels. We are comfortable. We have learned. We're comfortable with the absolute levels in some of those stores, but with the products that we are putting in and the changes we are making we believe will get the productivity to the same level over time. On the return on investment, we fully expect that investments in new stores have a 35 to 40 percent cash on cash return on investment. And I have to apologize I can't remember the third question.

John Zolidis - Buckingham Research - Analyst

Just some help on the tax rate for next year.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

We would have -- from a GAAP accounting perspective there will be no taxes next year. The loss carry forward -- well, I hope there are taxes but the loss carry forward is, I believe, between \$25 and \$30 million.

John Zolidis - Buckingham Research - Analyst

Okay, great. Thank you very much.

Operator

As a reminder [Caller Instructions]. Next we will move on to Steve Martin with Slater Capital.

Steve Martin - Slater Capital - Analyst

Hi, just a couple of questions. Does the acceleration of the vesting in the options change the share count for next year?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Under the treasury stock method, as long as they are below the exercise price it does not impact it. Obviously if our share price exceeds \$16 per share it can impact the share count.

Steve Martin - Slater Capital - Analyst

Okay. When you look out for '05 what do you expect the fully diluted share count to look like?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

We fully expect it to be somewhere between 14.5 and 15 million.

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Steve Martin - Slater Capital - Analyst

Okay. And in terms of the 60- to 65,000-square-foot stores and now that you have more experience opening them, can you talk about the opening model for that in terms of CapEx, preopening and the working capital requirement?

Mark Baker - Gander Mountain Company - President & CEO

Let me start off with that, Steve, and I'll let Dennis finish up with it. We moved to these 60- to 65,000-square-foot stores based on our experience of taking over some of these Wal-Marts, for instance, who had garden shops, that we can merchandise in the field and hold the salable product to a closer to an 80,000 with rents that were a \$200,000 at least less than our previous experience. So within that Dennis can kind of give you how it rounds into our model, which I think is pretty consistent.

Steve Martin - Slater Capital - Analyst

Okay.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

For our cash investment we would have the preopening expense. On a cash basis it will be about \$350,000 to \$400,000. We will have some of this non-cash early rent that will increase it somewhat for the preopening expenses. We spend between \$1.2 million and \$1.4 million for fixtures and equipment and then inventory net of working capital can be in that @2 to \$2.5 million range. So we would have an investment of perhaps \$4 million in a new location.

Steve Martin - Slater Capital - Analyst

Okay. So when you look out for full year '05 working capital based on approximately 20 new stores, would --

Dennis Lindahl - Gander Mountain Company - EVP & CFO

18 to 20 is the number that we are talking about.

Steve Martin - Slater Capital - Analyst

Okay. And on the marine, I know you've always said that on the ATVs it's big dollars but you make up the margin on the accessories. Can you give us the analogy for marine, is it the same kind of model.

Mark Baker - Gander Mountain Company - President & CEO

Steve, we don't have enough experience yet to be declaratory where our accessories are but we believe, at least initially, there are a lot of underserved marine accessory buyers in our markets today. So to try and figure out what the boat sale to marine accessory thing is a little difficult because we are very early stage. But from just a pure marine accessory business and the margins commensurate with accessory businesses we have a lot of confidence around our ability to serve that customer.

Steve Martin - Slater Capital - Analyst

Well, just out of curiosity not being -- for being a retail guy and not a marine guy what are the margins on those big boats look like?

Mark Baker - Gander Mountain Company - President & CEO

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You want to buy one I will help you finance it.

Steve Martin - Slater Capital - Analyst

There's only one retailer who sells them and I don't really cover him.

Mark Baker - Gander Mountain Company - President & CEO

We are actually satisfied with the way that these things are floor-planned and financed, that there is a profit opportunity here that we are comfortable with. Again the reason we're trying it in seven or eight stores, we want to make sure that we are right in the pro forma and we will build some experience around it and then we'll make a decision of how fast or how far we go with it after that. But, we are comfortable that there is a profit opportunity here.

Operator

Next we move on to Brad Purcell with Goodnow Gray.

Brad Purcell - Goodnow Gray - Analyst

I may have missed this but what is the working capital growth projected for '05 given the new store count, plus it looks like a mix shift in the SKUs that require higher working capital?

Mark Baker - Gander Mountain Company - President & CEO

I'm not sure I understand the question.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

We would --from a -- obviously we will have an increase in inventories of -- on a net basis of that \$2.5 million or thereabouts for the new locations.

Brad Purcell - Goodnow Gray - Analyst

That's per store?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Per store. So, obviously you've got about --it you rounded it to 20 because I can handle that, we are at \$50 million of additional working capital for inventory for the stores.

Brad Purcell - Goodnow Gray - Analyst

And you have projected \$45 to \$55 million in CapEx so the business requires \$100 million for rounding purposes. You mentioned you had financing secured, can you just flush that out a little bit what you planned to do on a longer term basis to finance the growth of this Company which over the next few years is going to require a good piece of financing?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

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We think that, obviously, this asset based lending facility will fund our growth for 2005. We need additional financing to support the same kind of growth in 2006 and 2007. We fully expect that either through the capital markets, either through some other kind of debt or equity placement in 2005 it will be required to fund 2006 growth.

Brad Purcell - Goodnow Gray - Analyst

Okay. And might you share with us what those plans might -- ?

Mark Baker - Gander Mountain Company - President & CEO

Not at this point in time.

Brad Purcell - Goodnow Gray - Analyst

Okay. Thank you.

Operator

Next we move on to Brett Hendrickson with Bonanza Capital.

Brett Hendrickson - Bonanza Capital - Analyst

I think I just missed something you said about CapEx. Did you say the previous budget was \$40 to \$45 million but now it's something higher? I missed the higher number.

Dennis Lindahl - Gander Mountain Company - EVP & CFO

Yes, I think last time we had indicated it might be between \$40 and \$50million, now it's between \$45 and \$55 million. The cash requirement actually didn't move from \$40 to \$50, but with the new accounting rules, that the tenant improvement monies that we receive no longer can be offset against tenant improvements property and equipment, they need to be set up as a deferred rent item. Our capital expenditure number increased but actually our cash requirement did not increase.

Brett Hendrickson - Bonanza Capital - Analyst

I didn't think the cash number increased. And then on -- did you just say that you are financing the boats with floor plan financing?

Mark Baker - Gander Mountain Company - President & CEO

Well, yes, all pretty much typical of that industry there's floor plan financing from the manufacturer as well as other third party that finance those pieces of equipment.

Brett Hendrickson - Bonanza Capital - Analyst

It's probably not a big deal now but just in case this gets to be a much bigger part of the business in a couple of years, then are the interest rates that you pay on that similar to what other guys pay on floor plan financing which I think is 10 percent, 9 percent right now?

Dennis Lindahl - Gander Mountain Company - EVP & CFO

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Generally the arrangements that, at least, we have when we talk about floor planning, there is a significant portion of time that is free, has no-interest rate on the floor planning, similar to terms under a payable situation. If we at that point in time decide to continue on the floor planning there is an interest rate change. When we talk about floor planning it is almost an interest free floor planning during the period of time we expect to hold the boat in inventory.

Brett Hendrickson - Bonanza Capital - Analyst

Okay, good. Thank you.

Operator

Next we'll move on to Adrian Doss with Hartwell.

Adrian Doss - Hartwell - Analyst

Congratulations on a great fourth quarter. Talk a little bit about how you came to the forecasting of 2 percent comps. Given the difficulties weather presented last year, you are working off low numbers on a go-forward basis. Can you just sort of talk in a little more detail about the rationale and the thought process there as we get into the back half of the year.

Mark Baker - Gander Mountain Company - President & CEO

Adrian, this is Mark. We want to make sure that we can jump over these hurdles. From a position of where we've come through this year, we want to make sure that we've got a number that we can exceed and feel comfortable with. At this point in time, we are very early in our year and, with 65 percent of the business occurring in the back half and being a little bit sensitive at the moment, you might guess, about getting too far ahead of ourselves, we feel very comfortable with that number at this point in time, and we will reserve the right to update that as we go through the season. But the first half of the year you can't read one way or the other. We obviously hope for more normalized weather patterns than we have seen in the past and the geographic diversity and the marine learnings that are ahead of us to build beyond that, but at this point in time that's all we are comfortable with.

Adrian Doss - Hartwell - Analyst

Second question, in terms of competitors and cannibalization of the opening of the new stores, can you just elucidate some more on how much impact in this current year you anticipate from the proposed new store openings and how much that also contributes to your two percent number

Mark Baker - Gander Mountain Company - President & CEO

We're very comfortable in competing with whether it's the mom and pops as we go off to these smaller third tier towns or frankly -- two years ago we built a 80,000 square foot store within 30 miles of one of the entertainment store retailers in the Twin Cities here. And then further built another 50,000 square foot store probably 20 or 30 miles to the west of them. We are very comfortable with our ability, particularly in our new formatted stores, to build stores, operate stores profitably with competitors. The one thing it probably does is it focuses us on our priorities when we need to update those stores. In the Twin Cities, for instance, with a new competitor coming to Rogers, we might have gone another couple of years before we would have updated all these stores in the Twin Cities. We probably have to accelerate that some. But our format from our customer point of view is a good place to find value; they shop us often. We're bullish on our ability to stand up and compete for consumers and win them over

Adrian Doss - Hartwell - Analyst

Great, thank you very much.

Operator

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And we'll take a quick follow-up question from Kevin Foll with Next Generation Equity.

Kevin Foll - Next Generation Equity - Analyst

Just a follow-up on the -- any comment on the performance by region in '04, kind of comp performance by region? So many different markets.

Mark Baker - Gander Mountain Company - President & CEO

Kevin, the thing that -- obviously, we have visibility toward is where the weather was -- might not have been -- as significant or competitive issues. And yet, you have to realize that 98 percent of our number comes from the Great Lakes regions, and the concentration of that weather and the phenomena that occurred in our significant back half was generally the same. As I called it, the tide receded last fall in new stores and comparable stores everywhere. That said, as we pointed out, our Texas entry, we've been very excited about that. We're excited about our opportunity in Kentucky and Colorado and Virginia. So a lot of our markets we're very excited about as we approach. And as we return and see what's happening through our spring and summer here, we feel good about being an Upper Midwest operator. If it's at all normal, we're going to have a great year.

Kevin Foll - Next Generation Equity - Analyst

And on the kind of stores in the West Virginia region, are those in the comp base yet then?

Mark Baker - Gander Mountain Company - President & CEO

It's not West Virginia it's Fredericksburg, Virginia, my fault. But, they're not in comp yet. Okay, thank you.

Operator

It appears there are no further questions at this time. I'd like to turn the call back over to Mr. Baker for any additional or closing remarks

Mark Baker - Gander Mountain Company - President & CEO

Thank you, Michelle. In closing I'd like to reiterate a few key points. The outdoor life style retailing is a great business that offers tremendous opportunity in a market that exceeds \$30 billion and is underserved at retail. Just reminding yourselves and us, the top 4 participants count for less than 15 percent of this great market. We are the largest participant in the outdoor life style market at retail. We believe our growth plans will keep us the leader because we offer our customers outstanding value in terms of pricing, extent of selection of products and services and outstanding customer service. We are a sales-driven organization. Sales growth is important to realize the inherent leverage of scale. We are focusing on improving our business in the first half by adding outdoor life style products that are appropriate for our customers, expanding our store base to broader geography.

Our associates have demonstrated their ability to manage the business and control costs in a difficult sales environment, keeping order costs flat as a percentage of sales and reducing inventory per square foot. At the same time we met our goal of adding 19 new stores this year on schedule and on budget. We have great confidence in our model and our ability to benefit from the advantages of scale. We've added stores, spare parts and services and we are confident we will realize these benefits. We expect to see margin improvements in the initiatives that we've begun in 2004, including the owned brand, operational efficiencies and labor standards, supply chain, freight and EDI. Leverage from our investment in upgrading our distribution centers also in front of us. We're focused on exceeding expectations in 2005. Thank you for joining us today. We look forward to speaking with you again after our first quarter.

Operator

And that will conclude today's conference call. Thank you for your participation.

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