

# FINAL TRANSCRIPT

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**GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call**

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Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

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*Stephens, Inc. - Analyst*

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## PRESENTATION

**Operator**

Good morning, everyone, and welcome to the Gander Mountain Company Second Quarter Earnings Release Conference Call. This call is being recorded. At this time I would like to turn the call over to our Director of Investor Relations and Corporate Communication, Ms. Shannon Burns. Please go ahead.

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**Shannon Burns** - *Gander Mountain - Director of Investor Relations*

Thank you. Good morning. I'm Shannon Burns, Director of Investor Relations at Gander Mountain. Welcome to the Gander Mountain second quarter conference call. Joining us on our call today are Mark Baker, President and CEO of Gander Mountain, Rick Vazquez, Executive VP of Merchandising and Marketing, and Dennis Lindahl, Executive VP and CFO. Mark will discuss business trends, Rick will review our progress on initiatives that we have in place to drive sales and margin, and Dennis will review our financial results. We'll take your questions after that. We expect the call to last an hour. As a reminder, the Q&A 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.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

This conference call is being broadcast real-time on the Internet at [www.gandermountain.com](http://www.gandermountain.com). We will also offer an 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 Archives in the Investor Relations section of our Web site.

Please remember 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 statement. Additional information concerning important factors that could cause our actual results to differ materially from these forward-looking statements are described in the "Risks and Factors Affecting Current and Future Results" section of our annual report on Form 10-K, as filed with the Securities and Exchange Commission, as well as in our subsequent reports filed with the SEC. These reports are available at the Investor Relations section of our website at [www.gandermountain.com](http://www.gandermountain.com) and at the SEC's website at [www.sec.gov](http://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. 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 update you briefly on certain pending legal matters. Regarding the consolidated securities class action litigation, as reported in our 2005 Form 10-K, on March 31, 2006, the plaintiffs filed a voluntary dismissal of their appeal, thus terminating the case. Regarding the companion derivative case, as previously reported, the district court granted our motion to dismiss this case. The time period to file an appeal has lapsed, thus terminating the case. Beyond these facts, we will not comment on pending legal matters.

I'll now turn the call over to Mark.

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**Mark Baker** - Gander Mountain - President and CEO

Good morning and welcome to Gander Mountain's second quarter conference call. I'd like to welcome our shareholders, analysts and all other participants. This was a promising quarter for us as we continue to see results from some of our operating initiatives we have been implementing over the past several quarters, including significant reductions in our operating and net losses for our seasonally slow second quarter, improvements in margin, effective inventory management, significant cost savings and improved through-put in our distribution center, and the continued control of operating expenses.

We were also very excited to open Gander Mountain's 100th store in Mooresville, N.C., as we continue to expand the nation's largest retail network of stores for hunting, fishing, camping, marine and outdoor lifestyle products and services. As mentioned in our press release, we also intend to open five new stores in the second half of this year - Lake Mary, Fla.; Charleston, W.Va.; Knoxville, Tenn.; Huntsville, Ala.; and Winchester, Va., - bringing us to a leading 105 stores in 22 states.

We also entered into some promising new partnerships in the second quarter. These include collaborations with Diver's Direct, Camping World, and Men's Outdoors and Recreation channel. Rick will update you on these later in the call.

I have said that we need to increase the amount of business we need to do in the first half in order to eventually report a profit in the second quarter. We are working toward that goal by expanding our store base in southern markets where people pursue more outdoor activities in the winter and early spring and adding the products to our spring assortment. With a firm grasp on product margin and controllable expenses, we believe we can over time make money in the second quarter as we grow our sales.

While sales growth in the quarter was disappointing and below our plan, we saw many of the same factors causing the softness in sales in this quarter that we saw in the first quarter. First, we reduced our spending on advertising and promotion by approximately 50% in the second quarter, as we did in the first quarter. We clearly saw the impact of reduced advertising in lower comp store sales during weeks where we were up against an advertising circular or other promotion from last year.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

However, we will return to historical levels of advertising and promotion in our upcoming peak seasons, when these dollars will be more effective.

Also, we had less clearance merchandising to offer our customers in the second quarter this year because we were better at buying the right quantities of, the right products at the right time this year and managing our inventory through our supply chain improvements. Lower levels of clearance merchandise had a negative impact on our sales but contributed to the higher margins we reported for the quarter this year.

Finally, we have nearly completed our conversion to an Everyday-Low-Price strategy. While this may have a negative impact on sales over the short term, we believe it is critical to giving our customers price confidence. We want our customers to understand and believe that they are getting the best value from Gander Mountain every day. They can be certain that they will not buy something from us for \$29 one week, and then find the same item 30 to 50% off the following week. We believe some of our customers who may be accustomed to waiting for us to have a sale, need time to adjust to our everyday-low-price strategy and positioning. However, they will become confident that they are getting the best value whenever they purchase anything at Gander Mountain. In addition, we continue to commit to our customers that we will not be beaten on price through our everyday-low-price and our Low Price Guarantee, whereby we will match any lower price on any product.

Further, as you recall, our comparable store sales results continue to be negatively impacted by approximately 2 percentage points by competition and cannibalization, which we expect.

We will continue to expand our store base and gain advantage of scale. This increasing leverage of scale is demonstrated by the 66% reduction in our operating loss this quarter. We look forward to further benefits as we add more stores. We believe that our strategy of focusing primarily on second- and third-tier markets provides a unique opportunity for Gander Mountain. As we enter these markets, we find that they are underserved, minimally competitive and these locations enhance our opportunity for success.

Before I turn the call over to Rick, I want to reemphasize our four key objectives; Build upon the Gander Mountain brand and significantly expand our network of retail stores in order to capture additional market shares; Offer our customers the best combination of a broad assortment of products and services, convenience and value in the outdoor lifestyle sector; Improve our profitability by increasing sales, leveraging our increasing scale to improve margins, enhance productivity, and by controlling expenses; And develop additional channels of distribution to reach our customers, including Internet, television, and catalog capabilities.

We are confident in our ability to grow our business and increase our profitability. Rick?

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**Rick Vazquez** - *Gander Mountain - Executive VP of Merchandising and Marketing*

Thank you Mark, and good morning everyone. I would like to update you on some of our initiatives to build sales during the remainder of the year.

First, Gander Mountain has a leadership role in the firearms business. We will strengthen that position with the goal of being number one. As an example, we recently strengthened our assortment with the introduction of tactical sporting firearms this summer. They are outperforming our sales projection.

I invite you to visit our stores later this fall to see the entirely new merchandising arrangement and improved signage in our firearms department. This new system - a first in our industry - will change how customers shop for these products. By organizing both firearms and ammunitions by use instead of by brand, we will make it easier for our customers to find the best products to meet their needs. The new displays and signage are designed to help the customers of all levels of expertise find exactly the

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

right firearm and ammunition. They are also designed to move the customer up to higher price points. Changes in the signage at our gunsmith service counter, which I will talk about in a few minutes, also add to our full-service dominance in firearms.

Second, we will drive sales through innovation, delivering new and exciting products to our customers. Examples of innovative products for fall include our new Guide Series bows, new fieldwear and new outerwear programs. This fall, 30% of the items in our archery department will be new products. We are also adding an exciting new product line to our power sports assortment.

Third, we will sell our products more effectively through improved in-store merchandising, signage, product adjacencies and cross-merchandising. We need to understand what activity our customer is buying for and sell the solution, not just the product. We have proven this builds the average ticket and increases customer satisfaction. We are experiencing great success with our fishing rod and reel combos this summer, even at the high end, with Fishing-to-Go sets, proving that customers respond well to attractive packages and better merchandising.

In addition to the new layout and signage in firearms and ammunition, customers this fall will see new displays designed for us by Garmin. These will call out our broad selection of auto navigation devices and enable us to take advantage of our customers' appetite for new electronics.

Fourth, we set more seasonal products in stores earlier this year. We brought in more inventory of hunting merchandise to our stores at an earlier date than we did last year. Our customers are giving us early indications of their excitement about our new hunting equipment for fall. Our early product sets enable customers to see our full selection as they put together their wish lists in anticipation of the upcoming seasons.

Fifth, while we stay on strategy to support branded products, we continue to find opportunities to develop our popular owned-brand product line. We are extending our assortment of Guide Series technical outerwear and fieldwear. For these new products, we have partnered with the best in the business, including Gortex and Primaloft. Our new line of Guide Series technical outerwear has the high performance characteristics of our fieldwear but in fabrics and colors for everyday wear. Based on the success we saw with the introduction last year, we are expanding our owned-brand line of men's and women's workwear, which is an important product line for our customers. Also for women and youth, we are adding GSX products, our high-performance line, and fieldwear.

Continuing to build on our customers' acceptance and preference for our Guide Series Brand, we have expanded our assortment deeper into the hunting lines with the introduction of Guide Series bows and water fowl blinds. We have partnered with the renowned Three Forks Ranch in Colorado, to develop a collection of high-end equipment and apparel for hunting and fly fishing. We will introduce The Three Forks Collection in 15 stores this fall, and selected apparel and footwear items in over half our stores.

Sixth, we will continue to grow our specialty services businesses - gunsmith, archery and power equipment - throughout our retail store network. Our service businesses build customer loyalty and drive incremental product sales. Our convenient locations make it easy for customers to take advantage of the services we offer. By making us the customers' retailer of choice, our service businesses drive repeat visits.

All of our service businesses achieved outstanding comparable store sales gain in the second quarter. Our archery service shops reported outstanding gains as we moved the shops out of the archery lane and into the tech service islands on the main selling floor, where they are more visible and have attracted more customers. Having the archery technician more available to customers drives incremental sales of accessories, leading to a larger and more profitable ticket. We now have archery tech service islands in about 30 stores, and we will continue rolling out that program to all of our stores over time.

We are the largest provider of gunsmith services in the U.S. Our gunsmith shops will have new signage this fall that presents all the extensive services we offer our customers in all of our stores. As the largest employer of gunsmiths in the U.S., Gander Mountain has a key competitive advantage.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

Seventh, we will continue to grow our power equipment business by enhancing assortments and increasing the number of stores offering these products. We have a lot of exciting new things going on in our Power Shop area. We're introducing a new line of go-carts that are being made exclusively for us and incorporate many quality features. The three models, with engines ranging from 90 to 250cc, are all two-seaters. These are an off-road alternative for young and old and are a great product line extension to our offering of ATVs.

We have rolled out a new customer financing and insurance program for all our Power Shop products. Having the right financing and insurance products available is an important tool, particularly for boat sales. Building on the success of our Power Shop business, we are enhancing our selling model in that area with best-in-class training and the introduction of a sales-based incentive compensation program. We believe this will enable us to attract, retain and motivate our great sales staff.

And finally, we will continue to build partnerships to broaden distribution of our products and to offer new product categories to our customers. We are very pleased with our roll-out of SCUBA gear in three stores this summer and the initial success of that product line. Our new store in Lake Mary, Florida, will offer the product category as well. We plan to add SCUBA gear into two additional stores in the back half of the year.

We are developing additional channels of distribution for our Guide Series line of products. We have partnered with Camping World, which is offering selected Guide Series products in their web store. The partnership with Camping World is a step toward our goal of positioning Guide Series as a national brand.

We just announced an exciting new partnership with the Men's Outdoors and Recreation channel. On September 25, we are launching a weekly hour-long program called Gander Mountain Lodge, which will feature demonstrations of our products that viewers can purchase by calling a toll-free number. More than half the merchandise will be apparel, with a focus on our Guide Series brand, including our best-in-class new fieldwear. The Men's Outdoors and Recreation Channel reaches 15 million viewers and the program will air twice each week in prime time. In addition to driving incremental sales and promoting the Gander Mountain brand, this is a terrific opportunity to showcase our owned-brand products and will help us position Guide Series as a national brand.

In addition, we continue to regionalize our product assortments to best meet the needs of all our customers. We have had great success in regionalizing our fishing assortments this year, thanks to our new regional product managers. As a specific product example, we have added the Dickies brand to our workwear assortment in our southern stores because of their popularity in southern states.

This is just a sampling of the initiatives we have in place to drive sales and enhance profitability. We will continue to pursue and enhance these initiatives, as well as look for additional opportunities to accelerate our growth. Our store associates are excited and our stores are ready for our peak hunting and holiday seasons.

And now I will turn the call over to Dennis Lindahl, our CFO, who will go into more detail on the financials.

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Thanks, Rick, and good morning everyone. I assume you've seen our press release we issued this morning. We have included more of our financial metrics in the press release this quarter and hope this format makes it easier for you.

This quarter, we improved the operating income margin 310 basis points compared to the second quarter of 2005. At the store level, we showed a profit of 6.2% of sales after occupancy costs, compared to 3.9% last year - a 62% increase. Despite the comp store sales decrease, we generated more product gross margin dollars in the comp stores this year than last year. On an operating basis, we generated positive cash flow from operations for the quarter. Cash generated at the store level increased 50% from the second quarter of 2005. We are satisfied with these financial results.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

We attribute the improvement in financial results to several factors. Initial product margin improved approximately 170 basis points as we benefited from the advantages of scale with our vendors, increased the penetration of our owned-brands, and saw the positive impact of our renewed emphasis on Everyday-Low-Pricing. Lower clearance inventory and better management of clearance merchandise and pricing also benefited margins.

We reduced advertising expenditures by approximately 50% in the second quarter compared to a year ago as the result of our decision that this investment did not give us a great enough return in terms of additional sales in the seasonally slower quarter. We will resume advertising and promotional expenditures at a level close to our historical pattern in the third and fourth quarters.

The investments we made in our distribution and supply chain processes have begun to pay dividends. We had a reduction in distribution costs in the quarter despite increased transportation costs. In addition, improved through-put effectiveness enabled us to lower inventory per square foot while making sure that we had the right products in the right store at the right time, and also reducing clearance inventory levels. We are confident that we will not have distribution issues this year.

Store labor costs as a percent of sales remained essentially flat as a percent of sales compared to the 2005 quarter. Labor costs as a percent of sales actually improved in our large-format stores. Store labor productivity measured in sales per labor hour improved 7% in the quarter. In the company's large-format stores, labor productivity gained 11%, despite lower-than-expected sales.

I'd like to review some additional metrics for the second quarter. Six stores entered the comp store base in the quarter. Our Binghamton, New York store which was flooded in June 2006, was temporarily removed from the comp store base for a net addition of five. Thus, our comp store base is 83 stores and includes 33 of our large-format stores. We expect to reopen the Binghamton store in late September.

Total square footage at the end of the second quarter increased 15% from last year to 5.1 million square feet. The average square footage per store was 52,000 at the end the quarter, compared with 48,000 in last year's quarter. We anticipate that most of our new stores will be in the 60 to 65,000-square-foot range going forward. However, we will occasionally open larger or smaller stores as we size our new stores appropriately for each market or take advantage of opportunities to use recycled real estate. Our average customer ticket increased 2.7% from \$50.75 to \$52.13 for the quarter, while the average ticket at our comp stores was \$50.80, almost unchanged from the second quarter of fiscal 2005. The average ticket at our larger stores is over \$9 higher than at our smaller stores, driven by the greater selection at our larger stores. Our Power Shop - ATVs, boats, and related products -- account for only about half of the higher average ticket at the larger stores.

Sales per square foot was \$168 for the latest 12 months compared to \$190 for the prior 12-month period, 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. The weighted average number of shares for the 2006 quarter was 14.3 million.

Turning to the balance sheet - I'd just like to comment on the 7.2% reduction in inventory per square foot in open stores at the end of the fiscal quarter. This improvement reflects the success of our initiatives to reduce inventory at all of our stores. Our vendors have worked hard to help us get the right product to the right stores at the right time for our customers, shipping us the product we need in time to get it in the stores for our earlier product sets this year. It also reflects rationalization of our assortment to offer customers a complete range of products with understandable distinctions along the good-better-best spectrum. The reduction also relates in part to our more effective targeting of inventory in recently opened stores. We continue to be confident in the quality of our inventory.

Store-related capital expenditures were approximately \$8 million in the fiscal 2006 quarter, down from \$19 million in the second quarter of fiscal 2005 because of the smaller number of store openings compared to last year. Capital expenditures include the new store openings as well as costs associated with store remodels. Of note, the three stores we remodeled last year are our top-performing stores this spring, which reinforces our confidence in the value of those investments. Total capital expenditures

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

in the second quarter of 2006 were \$13.6 million, which includes approximately \$5.5 million to replace the corporate airplane with a more efficient and reliable model.

For the year, capital expenditures are expected to be approximately \$35 to \$38 million, including the replacement plane, which was funded with long-term debt, and the reconstruction of the Binghamton store, which is being funded with insurance proceeds.

We currently have approximately \$20 million of availability under our credit facility. The company is in compliance with the covenants of the agreement, and we do not expect to have any issues with our bank agreement for the rest of the year. Remember that our availability tends to increase during the last half of the year. Our credit facility, together with our operating cash flow for the remainder of the year, will provide the company flexibility to fund our growth for the rest of 2006 and well into 2007.

The results this quarter reflect the impact of scale in retailing, even in seasonally slow quarters. We cut our operating loss dramatically this year compared to last year's second quarter. With 100 stores, we generated positive cash flow from operations for the quarter. As we continue to increase our store base, we are confident that we will achieve profitability in the second quarter.

We are focused on long-term growth and profitability. We are confident that our improvements in product margin are sustainable because we continue to increase direct imports, we continue to manage our inventory assortment and levels, and we continue to benefit from scale. We know how to effectively manage our costs and expenses. In the second half of the year, we will invest in store labor and advertising. Therefore, we may not see the same savings that we've realized in the first half of the year from reducing costs. However, we do expect these investments to drive sales.

Now we'd be happy to take your questions.

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## QUESTIONS AND ANSWERS

### Operator

[OPERATOR INSTRUCTIONS] We'll take our first question today from Paul Swinand from Stephens, Inc.

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### Paul Swinand - Stephens, Inc. - Analyst

Good morning everyone. It's Paul speaking for Rick Nelson who's out today.

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### Dennis Lindahl - Gander Mountain - Executive VP and CFO

Good morning, Paul

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### Paul Swinand - Stephens, Inc. - Analyst

Just a question on the marketing. You said you reduced your marketing 50%. Can you put a dollar figure on that or is that net of all -- that's all advertising in the circulars that you pulled on the first quarter and the second quarter?

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Mark Baker** - Gander Mountain - President and CEO

Paul, Mark Baker. We don't disclose our actual advertising dollars or -- for this purposes -- but obviously it's a pretty significant level of less circulars, less advert -- radio promotions that we presented to the public in the first half of this year and our whole message here is that we're going to obviously invest a little stronger in the back half where we've seen better results for our assortments and our customers.

**Paul Swinand** - Stephens, Inc. - Analyst

Okay. So you are going to re-weight some of that to the back half because previously on the call you said you were going to return to your historical levels. But I was under the impression you were actually going to advertise more in the back half.

**Mark Baker** - Gander Mountain - President and CEO

--Obviously, to make sure that we're protecting our, if you would, secret, we will be at least at the historical levels for the rest of the year.

**Paul Swinand** - Stephens, Inc. - Analyst

Okay. Fair enough. And then it seems like sales per square foot in the new stores were lower than we had modeled. Was there any kind of timing difference in the openings or where there some -- a smaller store that opened first and a bigger store that opened later or something? Or was that just due to the advertising reduction being at the new stores as well as the old stores?

**Mark Baker** - Gander Mountain - President and CEO

Dennis, maybe you can --

**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Paul, obviously I'm not exactly sure how you modeled the opening of all of the stores. I don't think that we saw any significant differences across our chain, whether it was size of stores, whether it was age of store as it related to the impact of some of the advertising. Certainly certain areas are impacted much more significantly by competition and cannibalization. But I guess I can't comment specifically on someone's model as to the new stores or the timing and whatever. I think we were generally in line opening the stores when we anticipated them. So Paul, I think I don't really have a good answer as it relates to your specific question on your modeling.

**Paul Swinand** - Stephens, Inc. - Analyst

Okay, fair enough. And then realizing it's hard to tell sometimes, but have you done any specific or have you noticed anything specific from Wal-Mart's hunting reduction yet? And do you think that will continue to accelerate in the back half of the year?

**Mark Baker** - Gander Mountain - President and CEO

Well I don't think we've seen anything in a significant way yet. Obviously we anticipate that, and we've been working closely with our suppliers because of being in the position that we are in the large firearm and ammunition distribution. And the broad-based -- with 22 stores, we are the most likely candidate to pick up that -- a change in their distribution. They're very early into their consolidation, although we have seen a couple stores where they've just recently open where they didn't open with

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

the product, where we were right next door to some of those stores. We've seen that have a positive impact on our penetrations in those markets.

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**Paul Swinand** - *Stephens, Inc. - Analyst*

Okay, thank you very much.

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**Mark Baker** - *Gander Mountain - President and CEO*

Thank you.

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**Operator**

And we'll take our next question from Mitch Kaiser at Piper Jaffray.

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**Mitch Kaiser** - *Piper Jaffray - Analyst*

Good morning, everyone.

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**Mark Baker** - *Gander Mountain - President and CEO*

Hey, Mitch.

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Morning.

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**Mitch Kaiser** - *Piper Jaffray - Analyst*

Nice job on expense control. I was wondering if you could talk about any patterns that you saw regionally or category performance? And maybe as you relate that to weather.

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**Mark Baker** - *Gander Mountain - President and CEO*

Let me start out with the general geography and I'll let Rick go into anything that he wants to talk about regarding our strength on item business as I continue. As you know we've continued to pioneer markets, like we opened up our first stores in Texas two years ago this fall. And now we've come through our second season. And it has rung true, at least in my mind, that it takes us a year to understand the seasonality, the preferences, the timing of the seasons and making sure that we have the right amount of inventory for these customers. So I think as we mature into some of these markets and -- what we've recently seen, and whether it's in Texas or New York -- we gain experience and knowledge and inventory management, we see those successes as we go into the second, third year in those markets, so that continues to be strong for us.

And I think Mitch, from -- our other point of course is we go to these second, third-tier towns where we consolidate that opportunity pretty quickly.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Mitch Kaiser** - Piper Jaffray - Analyst

Okay. And you're - just so I know, the second- and third-tier towns I mean, could you just speak more specifically on what markets you identify those to be?

**Mark Baker** - Gander Mountain - President and CEO

Well, I think if you think of Huntsville, Alabama, for instance or if you think of Terra Haute, Indiana, as we opened up last year to Paducah, Kentucky, or Tyler, Texas, earlier this year, those are the kind of markets where you might - might -- have a general sporting goods distributor but are not likely to see any of their large-box players in those markets. And we've got -- as we look across the -- our future where we see 300 or 400 stores, we see a significant percentage of those type of markets. As you know there's big percentage of those customers in those market that buy hunting and fishing license, we see some markets are 25 and 30% of the population buying hunting and fishing license in those kind of second and third-tier markets.

Rick can comment on some of the products if you'd like --

**Rick Vazquez** - Gander Mountain - Executive VP of Merchandising and Marketing

Mitch some of the things -- good morning. Some of the things that we're really excited about -- one of them in particular we talked about in the first quarter was our Turkey Sets and all that where we saw that newness and innovation is still something that customers come after. And that trend really worked its way through a lot of the other categories. I think our fishing was slow to start but has gained a lot of momentum of late. We're seeing a lot of good sales over in paddle sports and our used firearms business continues to be strong, which again the encouragement here is that folks are buying products for hunting, they're looking forward to it and getting revved up for the coming season.

**Mitch Kaiser** - Piper Jaffray - Analyst

Okay. And Mark, maybe just a follow-up question on the second- and third-tier markets. Could you just comment -- and I think you may have enough where you could just make a blanket observation rather than talk about specific stores -- just on the performance of those maybe relative to say some of the more urban markets?

**Mark Baker** - Gander Mountain - President and CEO

Well, the things that should be obvious -- obviously the expense-to-advertising model in those kind of markets are significantly less. And from a directional point of view for the customers finding you -- you are in the center where they shop, where -- when you're in a large metropolitan area such as Minneapolis, there are all kinds of alternatives for shopping dollars. So there's a key advantage in our business model for that. So certainly the labor costs tend to be somewhat less in those markets, and we've also seen somewhat less in the rent costs in those markets. So from those perspectives of cost and we also find again as I mentioned, a higher propensity of the activities that we sell to are generally enjoyed in those markets.

And overall we feel pretty good. Dennis, do you --?

**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Mitch, I don't want you to be misled that we aren't very satisfied with our metropolitan areas too. To the extent that we have sufficient penetration of market share like we do in the Twin Cities, they're very successful stores. As we go out into some other larger areas, we have less market penetration. It takes us a little bit longer to get them as profitable as we would like them to

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

be. So it's a combination I think. I don't want anybody to be misled that we aren't successful on these other ones. We just have opportunities as well in the second- and third- tier communities that perhaps some of our competitors don't have.

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**Mitch Kaiser** - *Piper Jaffray - Analyst*

Sure, I wasn't suggesting that, so --

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Good.

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**Mitch Kaiser** - *Piper Jaffray - Analyst*

-- don't take it that way. I was curious. I mean, other retailers I've talked to suggest that maybe when they go into those markets that there's less price competition. So potentially you could actually get better gross margin out of those regions as well. Would you be saying that as well?

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

I think there is that opportunity in those markets. Obviously there are fewer competitors that you have to mark down to or do price guarantees with, if you will. And I think that you have a market potential where we become the big game in town pretty quickly.

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**Mitch Kaiser** - *Piper Jaffray - Analyst*

Okay, sounds good. Thank you.

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**Operator**

We'll take our next question from Jeff Sonnek at Friedman, Billings, Ramsey.

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**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

Thank you. Can you talk a little bit more about the shift in signage, the internal changes that we would see inside the store? Does that imply, maybe particularly related to archery, any changes in the square footage allocation to some of these different categories as you - I mean, outside of the normal flexing in and out of seasonal businesses. But --

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**Rick Vazquez** - *Gander Mountain - Executive VP of Merchandising and Marketing*

Yes, Jeff -- [inaudible - cross talk] as far as the flexing of categories and what not, we're constantly evaluating after every season and prior to each season, what the right allocation is. So that's an ongoing process that we will do continuously. As far as the signing is concerned, the element that I was referring to that you'll see this fall in our firearms and ammunition area is just really giving the consumer more information, more timely information about the product, the use of the product, the recommendation, if you will, and helping consumers -- not only the novice to the sport but also even the expert whose been doing the activities for many years, to be able to look at different products and consider different alternatives, whether it'd be a brand or a type of

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

product. So you will see that in the firearms and ammunition area in a big way. In the spring of next year as we rollout some of those categories, you'll continue to see even more as we go into the spring sets in '07.

**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

And to a prior question to get back to advertising -- I don't want to beat a dead horse here. But just to be clear -- when you say you will be advertising at rates at least similar to last year's second half, are you talking about that in terms of absolute dollars or number of touches -- can you just define that?

**Mark Baker** - *Gander Mountain - President and CEO*

Dennis, whatever you -- so I think just from our purpose at the moment, and I'll let Dennis think about it for a second here, we made a very purposeful business decision in the front half after a year or two of experience to find out if we could drive incremental profitable sales to the front half. And when you've experimented, you also have to be willing to say what worked and what didn't work. We recognize that we overspent over the last year or two possibly on advertising that would drive traffic at a profitable level. We've shown that the back half of our year when we are in our strength -- whether it's hunting or cold weather apparel or the Christmas season -- we get a good return for advertising. So in this shift we made a decision we were going to spend obviously significantly in the back - in the front half, and spend somewhat more in the back half. And Dennis [inaudible - cross talk] --

**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

I think what we're really willing to talk about is the fact that to the extent that we've made savings in our store operating expenses as a percent of sales. I think what I alluded to in the comments is -- because we're going to invest a little bit more in store labor because we think there's a return on that and because we're going to invest more on advertising, we don't see any significant changes perhaps in the leverage that we're getting in store operating expenses as a percent of sales. Whether that is absolutely -- obviously from our perspective that would mean we would be spending absolutely more dollars than last year, but I can't tell you just the magnitude of that. And I can't tell you as a percentage of sales exactly what that is. But from that standpoint we -- directionally we would be spending in our stores kind of in line -- not substantially out of line -- with our expenditures last year.

**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

Okay. And then finally can you just talk about -- just give a little color around this television program you have. I mean, is that -- should we be thinking about -- I mean I've never seen the show so I apologize. But is that more of a Home Shopping Network kind of feel or is this more in the field interactive?

**Mark Baker** - *Gander Mountain - President and CEO*

Let me give a quick start of that and then I'll let Jeff - or Rick jump into that, Jeff. In the -- we look at the market out there and say, who could help us. And they came to us as well. What would be interesting for the consumers -- the Outdoor Channels have been very successful in driving consumers to them -- and there hasn't been yet a show that's much like Home Shopping Network or any of those others that focuses on really intelligently describing the product -- products disadvantages, the uniqueness of some of the products and how they're best used with experts -- pro-staff and some of our people from our stores, that could really take you through the advantages of the product. And much like the Home Shopping Network be able to get immediate gratification by ordering, or simply in our case maybe driving an advantage where these will come to our store and purchase in the store as well.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Rick Vazquez** - *Gander Mountain - Executive VP of Merchandising and Marketing*

Yes, and that's the essence of it, Jeff. It's -- we feel that so much of our product really deserves the quality explanation of how it performs, what are the characteristics that allow it to perform that way. And we see that this is a really good opportunity to reach that customer that's looking for our products. So we're excited. We think it's a great opportunity and really excited with what should come out of it.

**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

And then finally Dennis, can you just comment on what the private label penetration was both this quarter, last quarter and then the year-over-year?

**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

For this quarter, it was approximately 10%. That was about -- last year it was slightly under 9% so we had about 100, 110 basis point improvement in the penetration. I don't have off the top of my head what it was last quarter. Seasonally it increases going forward because of the additional penetration of some of the Guide Series fieldwear that Rick talked about, and some of the Guide Series sportswear and apparel that -- where our sales increase in the third and the fourth quarter. So our penetration will increase from 10% in the third quarter and in fourth quarter.

**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

Thank you.

**Operator**

Thank you. We'll take our next question from Sean McGowan from BMO Capital Markets.

**Sean McGowan** - *BMO Capital Markets - Analyst*

Hi, just a question about competitive responses in some markets. You've gone into markets where there were some established big bucks sporting goods retailers, and taking some initial share from them -- what has been your experience in subsequent years as they retaliate?

**Mark Baker** - *Gander Mountain - President and CEO*

Sean, we believe that the enthusiast would always prefer to shop at a full-line Gander Mountain store as compared to a general sporting goods distributor just because of the depth and the brand offers as well as the service offers, one of the things that I think you heard Rick talk about is we may not have been as focused as we could be on some of the new entries into the fishing or hunting categories. And merchandising and signing, such that if you're not an experienced enthusiast you'd feel even better about the experience at Gander Mountain. So I think from the point that we believe very strongly that we consolidate the enthusiast very quickly as compared to a big bucks general sporting good retailers. We may have not been as aggressive as we needed to be in making it a welcome for the early entry into the game.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Sean McGowan** - BMO Capital Markets - Analyst

Thank you.

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**Operator**

We'll take our next question from Bob Simonson at William Blair.

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**Bob Simonson** - William Blair - Analyst

Good morning. A couple of questions. The private label you just talked about -- could you say what it was for the full year last year and what it might be this year? And what's the goal or what's a reasonable expectation?

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**Mark Baker** - Gander Mountain - President and CEO

Well, they're flipping through these pages Bob, trying to find out what the numbers are. Directionally we have been making a lot of progress on our private label. And we're a little sensitive to calling it a private label versus an owned-brand Guide Series and what will eventually become Three Forks, is a brand that we now merchandise obviously through Camping World and our TV show. And it has been growing pretty significantly. Dennis, do you have the --?

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**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Actually Bob, our penetration was about 9.5% of owned-brand. For the full year we would expect it to increase hopefully several hundred basis points this year. And over time we will continue to be a national branded house but we will believe that we have an opportunity to certainly be in the high teens.

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**Bob Simonson** - William Blair - Analyst

Okay. And Dennis while you're on there -- from a liquidity standpoint you said you're going to spend about \$35 million on CapEx, including the plane. Your inventories, I guess, are peaking right now so that's why your revolver is used as it is. As you end the year, how do you think the balance sheet's going to look and what kind of flexibility do you have for new stores next year for CapEx?

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**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Bob, I think that -- I won't comment on your first question because that would be giving you guidance as to what I think the balance sheet looks like. But I don't see any reason that we wouldn't have the same seasonality as we would have had last year as it relates to going through the third quarter and the fourth quarter. So obviously by the end of the year we would see significant reductions in inventory and then we'd see reductions in our line and availability there.

We believe that we have funding in place to get us into 2007, to execute our plan. To the extent that we expect that we have not announced our growth plans for 2007 -- we haven't really committed to that -- and from the standpoint of committing to growth plans for 2007, we won't do that until we have financing in place. We obviously over time have always talked about -- we want to be a high growth retailer, our expectation is that we will grow over time at 20 to 30% a year. And we would like to get back on that path as soon as we can. So at this point in time we continue to look at all of the alternatives as to how we're performing in 2006, what our expectations are for growth in 2007 and determining how we're going to fund that growth in 2007.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Bob Simonson** - *William Blair - Analyst*

Okay. And on the inventory, you had \$66 down from \$71. Rick did mention that you brought fall in earlier. If that's up but the total's down, have you -- and I think someone was asking this earlier -- have you eliminated any categories or what makes up the difference if fall is in earlier?

**Rick Vazquez** - *Gander Mountain - Executive VP of Merchandising and Marketing*

Bob, a couple things. The -- we have not eliminated any categories but one of the things that we have been working hard on is the rationalization of SKUs where there's a lot of redundancy and duplication. And additionally I think the team has done a much better job of managing the inventory through the prime selling area or the prime selling season, so that our end-of-year clearance inventory is far less, which also helped us in the parts that Mark and Dennis mentioned, that we didn't have nearly as much inventory to clearance, which to some extent that kind of hurts a little bit on the sales side with the frenzy that's created around clearance. But it gives you a much healthier gross margin line as it's -- we're selling most of our inventory during its prime selling season.

**Mark Baker** - *Gander Mountain - President and CEO*

Bob, I think to finish it I think one of the terms that Rick used and you've heard in the past somewhere -- productline reviews and rationalizations. accounts for some of the margin-up that we've seen as well as SKU count reductions. And Rick has been driving that for the last six months in terms of that kind of activity.

**Bob Simonson** - *William Blair - Analyst*

Well, taking the responsibility for beating a dead horse here but on the advertising -- but not necessarily quantifying it. You had a nice improvement in your expense ratio. But you note in the questions have been on this advertising. Would you have had an improvement in your paying expense ratio if not for the advertising decline?

**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Bob, that's an interesting question because all of us would have to speculate what the sales impact has been as a reduction of advertising because I would -- we would have had some leverage but I can't tell you what the amount of leverage would have been, because obviously if we had spent significantly more on advertising we would have expected to drive some sales, whether they were profitable sales or not sales. So I believe we would have had leverage but I can't tell you to what degree.

**Bob Simonson** - *William Blair - Analyst*

Okay. And the last one, Mark you mentioned at the outset you're working towards newer distribution channels, Internet and catalog. Does this TV channel get you into an Internet channel that they have or can you update us on the ongoing issue of you getting back on the net.

**Mark Baker** - *Gander Mountain - President and CEO*

Here's what we want to do Bob. We want to be available to our customers in all the channels that they shop. We have focused on the retail channel and continue to put most of enhances on the retail channel. And some of our partners such as Camping World in using their site in supporting some of our brands like Guide Series -- that's been interesting. We think this TV programming, which is the next level of support which we plan to market, is a way that consumers today haven't been able to

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

really interface and buy product with. We're really excited about what can that be. How quickly we can market product that they can buy and get fulfillment directly from a 1-800 number. Or how they get excited about the product and take the drive to the store -- that's our next level. We won't make any comment about what the next timing of our next entree is but we are certainly getting closer.

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**Bob Simonson** - *William Blair - Analyst*

Can you -- given the restrictions that you're under -- can you go on the net with a GuideSeries.com or could you?

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

I think as we've always said, we only have limitations. We believe there are only certain limitations, if any, as it relates to a couple of trademarks, and Guide Series is not one of those trademarks.

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**Bob Simonson** - *William Blair - Analyst*

Is that a nice way of saying perhaps, yes?

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Yes, perhaps, yes. That is -- the answer to that would be yes.

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**Bob Simonson** - *William Blair - Analyst*

Okay, thank you very much.

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**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

You're welcome.

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**Operator**

[OPERATOR INSTRUCTIONS] We'll take our next question from Brett Hendrickson at Bonanza Capital.

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**Brett Hendrickson** - *Bonanza Capital - Analyst*

Hey, good quarter, folks. My question was asked and answered.

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**Mark Baker** - *Gander Mountain - President and CEO*

Thanks.

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**Brett Hendrickson** - *Bonanza Capital - Analyst*

Thanks.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Operator**

We'll take our next question then from Steve Denault from Northland Securities.

**Steve Denault** - *Northland Securities - Analyst*

Good morning everybody.

**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

Good morning.

**Steve Denault** - *Northland Securities - Analyst*

Where do things stand with Wal-Mart as it relates to firearms?

**Mark Baker** - *Gander Mountain - President and CEO*

Steven, the public communications that we've seen are very similar to everyone else's, okay. I believe it was about 1,000 of their 3,000 stores that no longer plan to sell firearms in the near future. We see that as obviously a significant opportunity. I know that they've opened a couple of new stores next to us where they didn't even start with firearms. And they were and may remain for a while, the number one firearms distributor in the US. We believe we're very, very close to the top of the pile, so we see it as an opportunity for us to replace that distribution. As again, because we are in 22 states and then we'll have over 100 stores by year-end -- I don't think that there's a better alternative out there for the suppliers to work with to drive that business back to the customer.

**Steve Denault** - *Northland Securities - Analyst*

Okay, but they haven't yet discontinued firearms as a category?

**Mark Baker** - *Gander Mountain - President and CEO*

Well, they are starting consolidating a number of stores right now. Just starting, we believe.

**Dennis Lindahl** - *Gander Mountain - Executive VP and CFO*

But they have not announced a discontinuation in all 3,000 stores [inaudible - technical difficulty], just around a 1,000 stores.

**Steve Denault** - *Northland Securities - Analyst*

Okay. Any new learnings as it relates to the Pierz Marine relationship.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Mark Baker** - *Gander Mountain - President and CEO*

I think the thing that we would comment on the boat business this year is we continue to experiment, learn how we can participate in the boat and marine business. We're a long way from declaring victory in that category but we continue to learn a lot. We still have, call it, 10 stores with full distribution. We've got a number of stores where we've got aluminum boats and loose Yamaha Motors that we've been very excited about and we continue to add stores to that list. But from a boat year, I don't think it was an extraordinary boat year. Our boat business is up but it's on a very small basis. And I think we're going to still be cautious about where we go with the boat business in the future.

**Steve Denault** - *Northland Securities - Analyst*

Thank you.

**Operator**

And we'll take a follow-up question from Bob Simonson with William Blair.

**Bob Simonson** - *William Blair - Analyst*

This is going to get too close, I suspect, to making an estimate but I'm just wondering -- in the second half of the year you're changing your advertising that will get picked up. The second half of last year and the year before were very disappointing for not only you but for the category in general. Be it some -- there is increasing signs that the consumer is slowing down on some of the more discretionary purchases. And were issues of either it was too warm, too dry, too hot, in prior hunting seasons. Is it a reasonable expectation or somewhat on the outside to assume that you have positive comps at some level in the second half of this year?

**Mark Baker** - *Gander Mountain - President and CEO*

That is a -- Bob, thank you for asking that very easy question to answer.

**Bob Simonson** - *William Blair - Analyst*

You're welcome.

**Mark Baker** - *Gander Mountain - President and CEO*

Here's the way I would best say it is. In the third quarter we last year experienced a very significant hurricane and I think some of us in the industry call it the CNN effect. Obviously we hope not to repeat that three of last year. Weather is a very significant variable in our game and to kind of forecast exactly what the coldness or the heat or the too-dry-or-too-wet issue, as you called it, in the third quarter, is one of the reasons we plan to continue to market in the third quarter assuming that opportunity will eventually exist.

And we've -- while we may not have been ecstatic about the fourth quarter last year, we were actually, as you know, generally pleased when we started to compete for some of the consumable dollars that were available to us in the fourth quarter. What I think we want to do is making sure that we get our message out throughout the third quarter, what it will be. We can take a full advantage of that that by the fourth quarter when there's a lot of consumable dollars out there. Even in a somewhat more restrictive consumable market, we want to compete for those dollars or get share. I'm not going to answer.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Bob Simonson** - *William Blair - Analyst*

Thank you very much.

**Operator**

And we'll take a follow-up question from Jeff Sonnek at Friedman, Billings, Ramsey.

**Jeff Sonnek** - *Friedman, Billings, Ramsey - Analyst*

Just following up on Bob's question, I mean, just as it relates to weather, was there anything in the second quarter which shifted kind of trends. I thought we came out of the first quarter doing a little bit better sequentially and yet the quarter ended up down. Was there anything you could point to there or care to comment on?

**Mark Baker** - *Gander Mountain - President and CEO*

I think from a weather perspective I mean, obviously we had some - a weather phenomena that wiped out one of our stores, which obviously impacted sales for a couple of days. When you have floods in New York and Pennsylvania -- obviously that was a kind of a tough period for there. But overall I would call this weather pattern -- it's just really more anecdotal than it is factual I think in the sense that we can prove it. I think the upper Midwest had probably one of the best springs and summers -- I can tell you from a lot of experience in the lawn and garden business. In some of those days that we count on some rainy drains to drive traffic into the store from construction workers, weren't as typical this year as they were in the past and the rest of the Midwest took the summer goes.

But I wouldn't credit the weather one way or another or blame it from the last 90 days in terms of affecting our business. It is just a seasonal quarter that -- I think it's really important, at least in our mind, that as Dennis pointed out, positive cash flows in this business, we would have more stores. We would expect to become profitable in the second quarter because we have a very significant population of our stores that are profitable through the last 90 days. But we made a real decision on not spending so much on advertising and some of the other expense areas. We think the second quarter is okay for our business, frankly. We're --

**Rick Vazquez** - *Gander Mountain - Executive VP of Merchandising and Marketing*

And I just want to make sure I reiterate the comment that despite the comp store sales decrease, we generated more product gross margin dollars in the comps stores this year than last year. So it was a combination of the advertising, the promotions, the clearance, some of those things that could negatively impact sales, we made sure that we managed the business and we're making sure that we were generating as many or more gross margin dollars at the locations. And maybe you reduce your advertising. Maybe you do give up some sales. When you have less clearance, maybe you do give up sales. So I want to make sure that we understand that in those stores even despite the comp store decrease we generated more product gross margin dollars.

**Mark Baker** - *Gander Mountain - President and CEO*

And more profit dollars.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Rick Vazquez** - Gander Mountain - Executive VP of Merchandising and Marketing

And more profit dollars.

**Jeff Sonnek** - Friedman, Billings, Ramsey - Analyst

Yes, that's very clear. Clearly a positive point on -- for the second quarter and hopefully going forward. Is there, relative to the third quarter -- as we kind of shift into some of these fall hunting seasons, waterfall, et cetera -- is there a kind of a point in the calendar where you really -- from a -- if you could just write it on paper, where you really hope you would see the weather shift to going from a more warm, comfortable environment to something very cold -- kind of prompting people back to the stores to buy some of that outerwear? Is there - is it a couple weeks out from opener or --?

**Mark Baker** - Gander Mountain - President and CEO

I think, Jeff that the long term plan has been I think -- and we have got a lot of now data and confidence that as we spread our geography, that has less and less impact to a cold weather date. We are more interested in the date on the calendar that is the season opener for dove in Texas, for deer in Pennsylvania, for fall pheasant hunting in the Dakotas or whatever the number -- date on the calendar is, is more important to us as we become more geographically diverse. Certainly in the upper Midwest, and we still have a big percentage of our population in the upper Great Lakes area, if it's cold by the middle of October, on a sustained-evening basis, we benefit. But it is not as significant as it once was and will continue to diminish in significance.

**Jeff Sonnek** - Friedman, Billings, Ramsey - Analyst

Okay. Good luck. Thank you.

**Operator**

And we'll take another follow-up question from Bob Simonson at William Blair.

**Bob Simonson** - William Blair - Analyst

Beating a second dead horse to death here. If your comps in the third quarter -- in the third quarter of last year they were down 8.5% and you had a negative operating margin of about 2%. If you had a flat comp would you make money in the third quarter?

**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Bob, I'm not commenting on that question.

**Bob Simonson** - William Blair - Analyst

I suppose that would be considered an estimate.

**Dennis Lindahl** - Gander Mountain - Executive VP and CFO

Might even be called guidance.

Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

**Mark Baker** - *Gander Mountain - President and CEO*

I think you might even try and answer these questions in Chinese or something.

**Bob Simonson** - *William Blair - Analyst*

I could try.

**Mark Baker** - *Gander Mountain - President and CEO*

Okay, thanks Bob.

**Bob Simonson** - *William Blair - Analyst*

Okay, thank you.

**Operator**

And it appears we have no further questions at this time. I'd like to turn the conference back over to Mr. Baker for any additional and closing remarks.

**Mark Baker** - *Gander Mountain - President and CEO*

Thank you, Cindy. I want to close on a few thoughts on the second quarter. Once again we demonstrated our ability to improve our financial results. We have a number of initiatives in place to drive sales and continue to improve our profitability initiatives, only a sampling of which we described in this call. We anticipate that we will see the results of these efforts in the second half of the year.

We have been committed and we will continue to be committed to our customers, our supplier partners and to our dedicated associates who provide great service everyday. We are extremely gratified by their ability to recruit, retain and promote the best associates, because they are the real drivers of our success.

Thanks for joining us today. We look forward to you in the third quarter

**Operator**

Thank you. That does conclude today's conference. We do appreciate your participation. You may disconnect at this time.

## Aug. 16. 2006 / 9:00AM, GMTN - Q2 2006 GANDER MOUNTAIN CO Earnings Conference Call

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