

FINAL TRANSCRIPT

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GMTN - Q4 2006 GANDER MOUNTAIN CO Earnings Conference Call

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IR Squared - IR

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PRESENTATION

Operator

Good day, 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 Mr. Bob Burton. Please go ahead, sir.

Bob Burton - IR Squared - IR

Thank you, good afternoon and thank you for joining us. Welcome to the Gander Mountain fourth quarter and year-end 2006 conference call. I'm Bob Burton of IR Squared. Joining us on our call today are Mark Baker, President and CEO of Gander Mountain; Rick Vazquez, Executive Vice President of Merchandising and Marketing and Bob Vold, Senior Vice President and Chief Financial Officer. Mark will discuss business trends, Bob will review our financial results and Rick will review our merchandise initiatives. We will take your questions after that. We expect the call to last about an hour.

As a reminder, the question and answer period is available to all interested parties, although questions will be limited to investors and analysts. This conference call is being broadcast real time on the Internet at 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 web site for approximately 90 days. The transcript of this call will be posted under 'Archives' in the investor relations section of our web site.

Remember that our discussion today make 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

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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 web site at gandermountain.com and at the SEC's web site at 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 we undertake no obligation to update them in light of new information or future events. The reconciliation and other information required to be disclosed about the non-GAAP measures, including EBITDA, discussed during this call are available on the investor relations page at gandermountain.com. Now I will turn the call over to Mark.

Mark Baker - Gander Mountain Company - President and CEO

Good afternoon. Welcome to Gander Mountain's fourth quarter call. We just completed a very strong year with record sales and operating income. Thanks to the hard work and enthusiasm of our associates, we have built the foundation for an exciting 2007. We've expanded a network of our retail stores and built Gander Mountain brand by building on some key objectives. We have continued to demonstrate that Gander Mountain has a portable retail concept which works across different geographies. As an example, we have had five of the six best store openings in our history as we expanded into Florida, Texas, Kentucky, Alabama and Virginia. We've proven our strategy can be very successful in Southern markets. We're building out a regional merchandising and storage organization to ensure that we reflect the important differences in climate and activity across the country.

We are working to gain the dominance in fishing, marine and both categories that we currently enjoy in hunting. During 2006, we demonstrated that our store model works very well in second- and third-tier markets. We've also developed successful stores in major metro markets like Houston, Texas and expanded our share in key areas like the Twin Cities, Chicago, Orlando. This tells us that our assessment of a 300-plus store opportunity nationwide remains intact.

We opened eight new stores in the year, bringing us to a total of 105 about stores in 22 states. 2006 also marked our entry into the huge Florida market. Heading into 2007, we have a single-store economic model that provides four-wall contributions in more than 90% of our stores. We still have substantial opportunities to take advantage of better performance in managing our inventory, improving our margins, growing our productivity and investing in our associates. Our ongoing ability to attract experienced and high-level management into our retail stores, even in new markets, tells me that we're on track with strategy. This gives us the ability to deliver the best customer service and gives us a unique regional approach.

Our planned 13 store openings over the coming year will be a great investment for our shareholders. 2007 includes three replacement stores that will largely fall in the second half of the year. In total, these stores will add approximately 750,000 square feet for growth between 13% and 14%. New store openings will include additional stores in emerging markets for Gander Mountain, such as Florida, Texas, Kentucky and Virginia.

Also during 2006, we made substantial progress in the flow of goods from our vendors through our distribution center to our stores. The progress we made in '06 is proving to be an additional tail wind, particularly in the first half of 2007. Rick will also comment on our discipline around pricing and marketing strategy which we will reinforce over the coming year.

You will see some new things at Gander Mountain in 2007. We're very happy to welcome our new partners at Tracker Boats and Mercury Marine, enjoying our existing relationships with Yamaha. We expect to have a full Tracker line at 34 stores and a smaller selection of market-specific products in all stores this spring.

Our commitment to footwear and apparel categories remains strong and validated by apparel performance in our Southern stores over the quarter. I'm enthusiastic about the improvements we see in our new positioning in merchandising which Rick will touch on in a moment.

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You'll also see us rolling out merchandising and presentation upgrades in our stores based on our successful experiences with merchandising initiatives in hunting and firearms in 2006 as we refine layouts, signing and presentation to our customers.

While 2006 had some great aspects, management was not satisfied. Sales grew 13% and comparable sales gains were a negative 1% on the year, reflecting a very slow start followed by a stronger second half. We continue to effectively manage our expenses and I was pleased with our ability to deliver incremental leverage, particularly in the second half of the year. As evidence that we did not buy sales with promotions on \$107 million of incremental sales, we were able to an additional \$17 million of operating profit, turning 16% of the sales increase to the bottom line.

I view the gains we made as a natural continuation of our work over the past few years. We have improved our developing product and marketing initiatives. We're managing our natural exposure to weather in key selling periods by better preparing for our peak hunting and holiday seasons.

I'm excited about 2007, and this year, investors can look for Gander Mountain to become a \$1 billion company. We'll continue to diversify our geographic base and build on the consistent execution in merchandising we saw in the second half of 2006 to maximize profitability. As our operations continue to expand both organically and through new stores, I believe that 2007 will be a watershed year. In fiscal 2006, Gander Mountain improved cash flows provided operations by approximately \$31 million. We expect to continue this improvement in fiscal 2007. Due to the strength of our store operations, we expect to accomplish our new store growth plan and upgrades without increasing our bank debt at year end. We're committed to our customers, our supplier partners and our dedicated associates who provide a great service every day. Bob?

Bob Vold - Gander Mountain Company - CFO

Thanks, Mark, good afternoon. Let me summarize the results and then I will go into more detail on the financials.

For both the quarter and year end, Gander Mountain reported double-digit sales growth, gross margin expansion and improved profitability from operations. As you read in the press release, Gander Mountain recorded a debt conversion charge of \$9 million in the quarter. This charge is related to our previously reported December transaction in which our current Chairman, David Pratt, entered into an agreement to purchase 5.7 million newly issued shares of common stock for \$50 million, which was paid with a \$30 million cash investment and the cancellation of a \$20 million note. This investment was very important to Gander Mountain. It improved our financial flexibility and helps enable our future profitable growth.

This charge reflects technical accounting requirements related to the conversion of convertible debt to equity securities and it's important to remember it's a one-time, non-cash charge; it has no impact on total shareholders equity or cash provided by operations. In fact, Gander Mountain's cash flow in stores was strong in fiscal 2006.

Examples of the stronger cash flows include, number one, operating income improved by over \$17 million for the year; number two; EBITDA as adjusted for the non-cash debt conversion charge more than doubled to \$37 million on the fiscal year; number three, cash flow from operations for the year increased approximately \$31 million.

Gander Mountain is a better business partner than ever as our operations improved year-over-year and our balance sheet gained strength.

Now let me review the quarter and year. Total square footage for the year increased 9.7% from last year to 5.5 million square feet. There were no new store openings for the quarter. The average square footage per store increased 2% to 52,200 square feet for the fourth quarter. In 2007, we expect this metric will continue to increase as we expect new stores to average approximately 65,000 square feet, plus additional outdoor selling space where we feature ATVs, our new Tracker boat program and other items.

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Our comp store base at the end of the year was 96 stores and included 47 of our large formats stores.

For the quarter, Gander Mountain delivered 16.4% sales growth to \$326.9 million, including a 0.4% comparable store sales increase. On the year, sales were \$911 million, up 13.3% on a comparable store sales decline of 1.1%, reflecting our slow start to fiscal 2006.

In the quarter, gross profit margin expanded approximately 80 basis points to 27.8% due to a number of factors. We improved initial margin rates for the fifth quarter in a row, despite unfavorable changes in sales mix, reflecting lower penetration of apparel and footwear for the quarter. Penetration of our own brands increased 80 basis points to 13.4% of total sales for the quarter.

Other positive margin impacts included increased co-branded credit card revenues and a reduction in property tax cost estimates. These increases in the quarter were somewhat offset by reduced vendor discounts as a result of fewer new stores and higher fuel costs.

On the year, gross margin also expand by approximately 80 basis points due to the following major factors. First, initial margin expanded resulting from, number one, increasing scale; number two, the positive impact of our everyday low price strategy; number three, continued higher penetration of our own brand merchandise; number four, lower clearance inventory coupled with better management, clearance merchandise and pricing. This overall improvement in margin rate was somewhat offset by our change in product mix.

Other items affecting gross profit for the year included the increase in co-branded credit card revenues, improved leverage from distribution costs, increased store occupancy costs resulting from lower comparable store sales, reduced vendor discounts due to fewer new store openings and higher fuel costs.

Turning to expenses in the quarter, store operating expenses increased 23.5% to \$50.6 million. As a percent of sales, store operating expenses increased from 14.6% to 15.5%. Planned efforts to drive sales in quarter four resulted in increased advertising and labor costs. For the fourth quarter, G&A increased 23.6% to \$11 million. As a percent of sales, G&A increased 3.2% to 3.4%.

For the year, store operating expense increased 8.4% in fiscal 2006 to \$167.5 million. As a percent of sales, store operating expenses decreased from 19.2% to 18.4%, reflecting the reduced marketing and advertising in the first half of 2006.

G&A expense increased 12.2% in fiscal 2006 to \$40.4 million. As a percent of sales, G&A decreased from 4.5% to 4.4% for the year. In the year for the first time, G&A included approximately \$900,000 of stock option expense or approximately 10 basis points as a result of Company's adoption of FASB 123(R) at the beginning of fiscal 2006.

Net interest expense was \$4.9 million for the quarter compared with \$3.9 million last year, reflecting higher effective interest rates. On the year, net interest expense was \$19.2 million versus \$11.1 million in the prior year, reflecting both higher borrowing and increased effective interest rates.

Fourth quarter net income of \$15.3 million compared to \$22.2 million in the prior period. On the year, net losses were \$13.2 million compared with net losses of \$13.3 million in 2005. Comparisons of earnings per share year-over-year are affected by the Company's issuance of equity capital in December 2006 which increased the number of weighted average shares outstanding year-over-year and particularly in the fourth quarter of 2006. Diluted earnings per share for the 2006 quarter were \$0.85 compared with \$1.45 in the comparable period, while losses per share for 2006 were \$0.88 compared with \$0.93 in fiscal 2005.

The weighted average diluted shares for the quarter were 18.1 million shares compared to 15.5 million in the prior period. For the year, the weighted average shares were 15.1 million shares compared with 14.3 million in the prior year.

We ended the quarter with bank debt of \$168 million and shareholders equity of \$197 million. As a result of the December equity transaction, we amended our credit facility with our banks to effectively lower our interest rates. As of year end, we had

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approximately \$51 million of availability, and as of today we have approximately \$45 million of availability under our credit facility.

From a cash flow standpoint, capital expenditures including capital leases were \$39 million for the year versus \$60 million last year. This includes \$5.7 million of expenditures associated with our replacement airplane which was funded with long-term debt and approximately \$1.8 million of capital costs associated with the reconstruction of the Binghamton store which was flooded in June 2006 and funded with insurance proceeds. We expect capital expenditures to be in the range of \$40 to \$45 million for the coming year.

Overall I'm encouraged by the cash generation of our business for the past year and the potential for continued improvement in many areas in 2007. As Mark noted, in fiscal 2006, Gander Mountain improved cash flows provided by operations by approximately \$31 million. We expect to continue this improvement in fiscal 2007. Due to the strength of our store operations, we expect accomplish our new store growth plans and upgrades without increasing our bank debt at year end.

Now I will turn the call over to Rick.

Rick Vazquez - *Gander Mountain Company - EVP, Merchandising and Marketing*

Thank you, Bob, and good afternoon everyone. Overall I was pleased with our fourth quarter performance. Slightly positive comps were not as strong as planned in part due to the challenging December, the warmest on record in the upper Midwest, but did reflect better execution of our merchandising and store initiatives over the past year. Despite the comp store challenge we had in the fourth quarter, I am encouraged that our sales number was supported by our strong comps in the South where we have 20 of our 105 stores.

During the quarter we saw strong results in hunting with double-digit comp increases in ammunition, black powder, firearms. These are areas where we have rolled out new signage and organized our assortments by use or what we're calling solution-based merchandising.

Our camping and marine business was also particularly strong in November with success in holiday items, such as kayaks, smokers, food preparation and marine electronics. Both fishing and apparel were affected by warm December but rebounded nicely as January returned to seasonal temperatures. We saw ice fishing comps down sharply in the northern regions, but as an example of how our growing geographic diversification can help balance sales, the rest of fishing grew by more than 8% on the strength of our Southern business.

Overall, apparel comps were soft on the quarter reflecting the mid-quarter weather in items like item what outerwear and pack boots. The lack of traffic also affected sportswear performance. Nevertheless, we also had a good clearance sell-through thanks to colder temperatures in January.

Our assortments are cleaner and more focused than a year ago as items on our weekly replenishment base produced the highest comp growth in the fourth quarter of 2006, allowing us to balance in-stock with higher sell-through. On this late sales strength, we do go into 2007 with much cleaner inventory. Our inventory per square foot in open stores is \$63.66, up 3.3% from the prior year. On the year, inventory turnover improved slightly to 1.7 times which continues to be a great area of opportunity for us.

Overall, you will continue to see Gander Mountain making changes in apparel area to deliver assortments that perform better under varying weather scenarios. In 2007, you will see us upgrading the apparel shopping environment to a more inviting and shoppable ambience. We call this layout the Middletown apparel set as we tested it first in our New York store. It features carpeting, more wood tables, folding tables and mannequins. We will upgrade 16 stores to the Middletown apparel set by the end of the second quarter, which, including new stores, will bring us to 30 stores by year end. We will apply the layout discipline from the Middletown project to the remainder of our stores.

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To lead this effort, we have also added Rick Rusch as Divisional Vice President of our Apparel and Footwear segments. Rich has more than 30 years of apparel retail experience, the majority with Land's End. He will bring his considerable experience to the existing assortment and develop our approach to a broader customer base, including women and children through the more upscale product over the next year.

Sales per square foot declined slightly to \$175 for the year as a result of comparable store sales and increasing penetration of larger format stores. Our average customer ticket increased 2% to \$59.53 for the quarter and 4% to \$57.02 for the year. This reflects the increasing number of larger stores in our mix where the average ticket is more than \$12 higher as well as our solution-based merchandising.

Over the past year, I have discussed a number of initiatives and to drive sales and margin. As we move into 2007, let me update you on those and the areas of emphasis we see for the coming 12 months.

First, we will drive our initiatives to improve sales volume by continuing to strengthen leadership categories like firearms and hunting equipment. We know from the data available to us that we are a leader in this category and we continue to take market share.

We're particularly excited to see the rollout of Tracker boats this spring. This is a big deal for us. We have spent two years testing this \$6 billion market and its effect on related businesses. We expect this to have a halo effect on other categories, such as marine and water sports. We have recently launched this initiative which means that the full impact on sales and margin will emerge over the first half of the year. We expect to have the full Tracker assortment in 34 stores and selected items like john boats and loose motors in our remaining stores by April.

We will accelerate the ongoing project of moving all of our departments to truly regional entities. We started implementing the regional merchandising structure by adding three fishing buyers last year. We're deploying two more regional buyers in the Southern region to cover other categories, such as hunting and apparel and footwear and we continue to refine assortments with relative SKUs. In our stores, we will focus extensively on improving the customer shopping experience through product adjacency and signage and continued emphasis on our everyday low price.

In advertising, we are changing our campaigns to more radio than print to reach a broader base of target customers more effectively. Last year, we were balanced between print and radio. This year, we will use print as part of our grand opening package in selected pieces, however, our primary vehicle will be radio. We will also leverage our TV show. We moved from for the Versus Channel to the Outdoor Channel. Along with numerous other shows we sponsor, we feel we will have a strong brand presence with this target audience.

Turning to product adjacencies and signage, I mentioned the strong results we saw in firearms and ammunition from our solution-based merchandising. We will roll out this point-of-purchase signage and arrangements across the categories that guide the customer through the selection process. We provide information throughout the stores from our knowledgeable associates, in-store signage and merchandising techniques that help our customers make the best choices for their outdoor lifestyle. In the spring, customers will see new signage in optics, fishing and marine departments, similar to the signage we introduced this fall for arms and ammunition. This will make it easier for the novice as well as expert to find the right equipment for whatever activity they have in mind. We're seeing that our everyday low price approach is gaining traction by reducing the sales spikes associated with a highly promotional pricing strategy, particularly in apparel. We continue to gain confidence that our customers endorse this approach.

Bob mentioned that we have expanded our initial product margin for five quarters in a row. Our goal is to continue that trend throughout the rest of 2007.

And now I will turn the call over to the operator as we are ready for questions.

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QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Bob Simonson, William Blair.

Bob Simonson - William Blair - Analyst

A couple of number questions. Do you have an estimate of the pre-opening expenses, your (indiscernible) store openings this year (inaudible)?

Bob Vold - Gander Mountain Company - CFO

Again, store opening, we're going to open 13 stores next year versus the eight that we had this year. It will be very similar to the \$400,000 basic average that we had from this last year standpoint.

Bob Simonson - William Blair - Analyst

Okay, and do you have a number for how much of a tax loss carryforward you have left?

Bob Vold - Gander Mountain Company - CFO

Our tax loss carryforward at the end of this fiscal year is \$54 million.

Bob Simonson - William Blair - Analyst

And is 20 million a good number for the shares for this year?

Bob Vold - Gander Mountain Company - CFO

20 million is approximately the number of shares outstanding, just slightly over that. If you look on the balance sheet, there will be, depending on the price, there will be an incremental impact from the dilution effect if stock options, at various prices. That number will increase slightly.

Bob Simonson - William Blair - Analyst

And do you have a number if it was this price today, 10-ish?

Bob Vold - Gander Mountain Company - CFO

\$10, approximately 400,000 shares.

Bob Simonson - William Blair - Analyst

So it would be about 20.5 or something like that?

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Bob Vold - *Gander Mountain Company - CFO*

Correct.

Bob Simonson - *William Blair - Analyst*

I'm sorry, I missed when you said what the option expense was. Did you say \$100,000 for the year?

Bob Vold - *Gander Mountain Company - CFO*

No, the option expense for the full-year is about \$1.3 million. The \$900,000 was the impact for the year that was in G&A.

Bob Simonson - *William Blair - Analyst*

So it was -- I'm sorry, is it \$2.2 million in total?

Bob Vold - *Gander Mountain Company - CFO*

No, the total is \$1.3 million, of which \$900,000 is in G&A.

Bob Simonson - *William Blair - Analyst*

And what was it in the quarter?

Bob Vold - *Gander Mountain Company - CFO*

The quarter is about -- the G&A component was about 350, so it's slightly higher, I mean, 370, 380, for all categories for the quarter.

Bob Simonson - *William Blair - Analyst*

And do you have a guess on that expense going into this year?

Bob Vold - *Gander Mountain Company - CFO*

That will increase slightly. It will be dependent upon the number of options that we exercise -- or not exercise, but issue later on this summer and throughout the year.

Bob Simonson - *William Blair - Analyst*

And Mark, could you talk a little bit about the expense increase at the store level on the fourth quarter, and what is a reasonable expectation going forward? I know you are not keen on making any forecast at least at this time, but can you talk generally as it to in '07, without making a dramatic -- say something like a flat comp this year, is there the potential for margin improvement? And if so, would that be on the expense or the gross margin line, or could it be both?

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Mark Baker - Gander Mountain Company - President and CEO

Bob, that's a long question, but I think I've got it all. The question is about -- do we see margin growth continuing? The answer is, absolutely yes. We have had five quarters in a row and we'll continue to work through imports, product mix and from the merchandising part of the business, the margin expansion will continue certainly in this business. We will always expect and always have a very significant November-December time period driven by the hunting business and the outdoor activities that all of our markets enjoy as well as the holiday season and we will staff appropriately and make the investments in advertising and staffing for the fourth quarter. Clearly, this fourth quarter was impacted somewhat negatively in these Midwest markets as Rick mentioned, but the real thing that's long-term is this growth that we have in these Southern stores. As Rick pointed out, the comps that we saw and the absolute growth in these Southern stores are very exciting.

Bob Simonson - William Blair - Analyst

I think you said that January came back and November was pretty good, so were the expenses -- was the expense ratio flatter in November and January and the damage was done principally in December or --?

Bob Vold - Gander Mountain Company - CFO

Bob, I will answer the question. Really, you have to look at it in the two-part component. We staff from a labor standpoint with the expectation of normal sales activity in the month of December. Because of the warm weather, we were clearly impacted in the footwear and the apparel categories at higher margins. We specifically with the intention of wanting to move out of fiscal 2006 with clean inventories, so we spent money in radio advertising for the month of January. And as Rick talked to the fact that we cleared out a lot of that inventory in the month of January at lower margins. So it's really a combination of labor costs in December, shortfall sales in December, increased radio advertising really in the month of January combined to give us the overall impact for the quarter. From an overall standpoint, we would expect to leverage store operating expenses on a go-forward basis.

Bob Simonson - William Blair - Analyst

Could you do that on a flat comp? Or, ask it differently -- how much comp do you need to get leverage on store expenses?

Mark Baker - Gander Mountain Company - President and CEO

Let me see if I can answer that question. We have leveraged store expense with most comps. This particular quarter where December is such a huge inflection obviously, you have a lot of investment both in advertising and labor to serve our customers correctly. We're negative impact, but we expect over time all of these quarters that we can get leverage at a very small to flat comps.

Bob Simonson - William Blair - Analyst

Okay, perfect. Thank you very much.

Operator

Jeff Sonnek, Friedman Billings Ramsey.

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William Wallis - *Friedman Billings Ramsey - Analyst*

Hi, guys. Actually, this is [William Wallis] on for Jeff. I wanted to ask a couple of questions about stores in your Southern markets. I guess first off, are of the new store openings this year going to be in the Southern markets?

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

William, we have not released exactly where all 13 stores are going to be for competitive reasons just yet. But, if you look at the math, you can tell that largely our growth is available to us in the Southern markets and we have a couple of our replacements which we've talked about, three of them which obviously would be in the Northern part of our business. So I think if you just suggested it, it would probably be that 70% to 80% of growth would be in the South, I think you're in the right range.

William Wallis - *Friedman Billings Ramsey - Analyst*

And obviously the comps are outperforming. Are the store metrics on the newer stores, are they similar to the previous -- the northern store metrics, or are the volume levels lower but better expenses? What are we looking at sort of four-wall profit?

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

The question about the '06 openings which we mentioned about how they're some of our best grand openings ever, and obviously, these are early reads, but these stores are very exciting and are exceeding the \$200 a square foot range for us, which we are very excited about what that can do to drive four-wall profitability. And we continue to plan to add to that dimension. We've seen that in a number of markets.

William Wallis - *Friedman Billings Ramsey - Analyst*

Are they cheaper to operate rent-wise? I would think perhaps they might be, but I don't know.

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

They're all site-specific on what it costs, whether they're recycled or build to suit. In some cases, the energy costs we find in some of the markets are a little higher because there's more air-conditioning required. But generally, the building and operating costs are the same.

William Wallis - *Friedman Billings Ramsey - Analyst*

Okay. The last question is a little bit more color on advertising. Are the dollars expected to be the same in '07? Are you just shifting dollars?

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

I will let Rick finish out that question. About advertising, the thing that we want to do with Gander Mountain is making sure we get our brand out and communicate it in these new markets as well as reinforce as Rick pointed out the broader reach of radio and TV has done for us.

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Rick Vazquez - *Gander Mountain Company - EVP, Merchandising and Marketing*

Hi, William. In marketing, one of the things we did last year was shift our marketing to reflect more the sales curve for the year, and that's something that we will continue to do this year. We found good success in that. So from a trend standpoint, you should see the same. The one thing we do do is we support each and every one of our markets for what the needs of that market are. So for example as we go into more Southern markets and continue to open stores there, that will drive some of the marketing earlier on in the year and those stores -- since those stores kick in their fishing seasons and early hunting seasons than those in the North. So from that standpoint, I think what you will see is a very comparable trend, but everything built up from the needs of the market.

Another point is, as we go into new markets is you can anticipate new markets do require a higher level of commitment and investment into that market for advertising, as opposed to going into a market where we are back-filling and leveraging the advertising that's already occurring there.

William Wallis - *Friedman Billings Ramsey - Analyst*

Okay. And my last question is, with your ramp and store openings, would we expect vendor discounts to be a benefit to gross profit in '07 versus a drag?

Bob Vold - *Gander Mountain Company - CFO*

Yes, exactly the opposite of what we saw in fiscal 2006. As we cut back the number of stores we open, we'll expect to see the benefit in 2007 as we open additional stores.

William Wallis - *Friedman Billings Ramsey - Analyst*

Any willingness to quantify that?

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

Not at this time. But it's exciting for our suppliers to see this kind of growth and we would like to be the best outlet for our suppliers and they're very anxious to grow their businesses with us and get the shelf space with some of the best associates. But we don't release that little piece of what that means yet.

William Wallis - *Friedman Billings Ramsey - Analyst*

Thank you very much.

Operator

Reed Anderson, Davidson.

Reed Anderson - *Davidson - Analyst*

A couple of questions. Mark, you had commented that I think you said the initial mark-up last five quarters has been trending higher each quarter, and I'm just curious if you -- it sounds like the outlook is for more of the same. If you couple that with

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everything else going on and then you bring in boats into the mix and stuff, is it reasonable still to assume that just on a reported basis, gross profit margins will tick up a little bit this year and next year, just kind of gradually?

Mark Baker - Gander Mountain Company - President and CEO

That really is a good question, and I think I will preface that by saying, if we require at some point in time to break that out and show powersports, because it may become a very significant part of our business over time, break out those margins and share that, we will do that at the appropriate time. But we do expect that gross margins at a reportable level will still continue to grow at reasonable levels that we had been growing at in the past and continue on.

Reed Anderson - Davidson - Analyst

That's helpful. Thank you. And then a question for Rick, I just wanted to clarify. In your prepared remarks, you said that hunting was up double-digit comps in the quarter. Is that correct?

Rick Vazquez - Gander Mountain Company - EVP, Merchandising and Marketing

That's correct.

Reed Anderson - Davidson - Analyst

And by that, did you mean the whole hunting category, which is 40%-plus of your sales, or were you just specifically talking about guns and ammo or something like that?

Rick Vazquez - Gander Mountain Company - EVP, Merchandising and Marketing

I was specifically referring to certain categories within the hunting, which I mentioned ammunition, black powder and firearms.

Reed Anderson - Davidson - Analyst

That's what I thought, but I just wanted to make sure. Also, too, you were running some promotions in the fourth quarter relative to firearms. Were you not?

Rick Vazquez - Gander Mountain Company - EVP, Merchandising and Marketing

Not promotions per se. We are not -- in an everyday low price environment, we are not playing the high-low game. We will run clearance when the inventory needs to be cleared, and that's very acceptable in an everyday low price environment. And, we will, as we get -- if we get a special price from a manufacturer where we can pass on savings to the consumer, we will pass on a hot buy to the consumer, but not with the intent of doing any kind of high-low promoting.

Reed Anderson - Davidson - Analyst

Okay, good. So it was not anything abnormally different, it's just you had a good guns season, that sort of thing?

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Rick Vazquez - Gander Mountain Company - EVP, Merchandising and Marketing

You bet.

Reed Anderson - Davidson - Analyst

Okay, and then, in terms of the back to Bob's initial question, which you answered pretty much most of my stuff, I just want to probe it a little bit more. I guess what I struggle with is, I look at the fourth quarter, I know you had a lot of things going in there and December did not work out quite right. But even if you look at the first half of '06, and even on down comps, if your sales were up and you were up 16%-plus this quarter, you were still actually leveraging SG&A -- or store-level expenses. And when we get to this with, again, sales overall are up over 16%, and then we see kind of a disconnect. And I guess I'm still having a hard time reconciling that. I'm just wondering if you can -- if there's anything else you can add to that that can assure me that this is more of an unusual event because of the timing of your monthly sales or whatever?

Bob Vold - Gander Mountain Company - CFO

I think you really have to look at December being, and how significant it is to our overall business. It was in categories -- apparel, footwear, ice fishing -- that are very high margin categories for us on that standpoint. And, when you combine with what both happened in the month of December and in January, it is significant from a margin dollar standpoint. And there's no question, we believe we did the right thing in clearing that product out as we moved into 2007. But, clearly, we believe it isn't an item that's representative of a similar event that we would have to do it each and every year. We're always going to be subject to abnormal weather patterns. That's always going to be the case. But from an overall standpoint, we don't believe that it's representative of something that's going to happen every year.

Reed Anderson - Davidson - Analyst

Super, that will do it for me. Thank you.

Operator

(OPERATOR INSTRUCTIONS). Paul Swinand, Stephens Inc.

Paul Swinand - Stephens Inc. - Analyst

Good afternoon, everyone, and congratulations. I'm on the call for Rick Nelson, who's out today. First question is on the boats. When we talked and when you had the analyst day in Florida, and now that you're continuing to be excited about the boating segment, can you give us just an idea of how big boats were in the fourth quarter and how big you expect them to be for the full year of 2007, is that fair?

Mark Baker - Gander Mountain Company - President and CEO

I will start that, Paul, for a second. Boats in the fourth quarter were pretty small, other than as you saw in Florida and our markets that might be generally appropriate to boating and maybe south Texas, most of the boat markets are pretty well limited at that time of year and we had not rolled out any of the Tracker stores until about five or six weeks ago. So that new effort had not been exposed. So the fourth quarter is seasonally the smallest I believe nationally in the boat business, but we were seeing -- Rick and I can talk about it for a moment -- some very significant sales in the Texas market as we entered the beginning of this season and some of the boat show activities where we were showing for the very first time, we were selling dozens of boats, which was pretty interesting for us on a store level.

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Paul Swinand - *Stephens Inc. - Analyst*

Where I'm going with that is, is the first-half sales and margin environment going to change significantly if we are modeling off of last year because of the boat business?

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

I pointed out earlier that if we need to point out the separate part of power sports, and recall that we're in the boat business, but we're also in the ATV business in a very significant way. So we have a lot of these margins that you -- already into our system, if you will, in our experience. It's my expectation we're going to be able to grow margins on all levels in the coming year.

Paul Swinand - *Stephens Inc. - Analyst*

But the sales in the first half aren't going to move the needle just yet?

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

Sales, we expect we'll have some certain growth in our boat business, and as Rick pointed out, the halo that affects our marine and water sports business is significant and those have significant margins in it as well. So it was a very early read, but we really are excited about it. We've been selling boats every day and every week and in a lot of stores, we're not quite finished rolling out these boats. So it's hard to share with you exactly, but we will in a couple of months share those numbers with you.

Paul Swinand - *Stephens Inc. - Analyst*

Okay. And then the receivables were up considerably, and I'm assuming a portion of that is probably the boats, but can you give us any kind of a dollar breakdown of what that was due to? I'm sorry -- I said receivables -- accounts payable?

Bob Vold - *Gander Mountain Company - CFO*

Payables is a combination of factors. Part of it is, the reality is, we have better terms with vendors as a result of the \$50 million equity infusion at the end of December. At the same time, part of the inventory increase is the fact that we have moved more inventory in at the end of the year to be ready for the spring sets, and that has an impact as well as the impact of power sports, which includes boats and ATVs, again, and we've brought larger volumes in there as we've ramped up here going into the beginning of the year as well. So it's really a combination of all three of those factors.

Paul Swinand - *Stephens Inc. - Analyst*

Fair enough. I know you have guided that you want to have positive comps in the long run. One thing I'm wondering is, as the mix shifts more to large format, are the new stores expected to comp better, and might your comp just get a little tail wind from the mix change, both in the format and the geographical location?

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

That's a good observation, that we have 96 stores was it, Bob, in comp now today -- obviously, a big percentage of those are new stores and formats we've created over the last four years. Those stores as you might guess are the stores that can accept the boats and the larger power equipment, power sports investments and probably will reap the bigger benefits over time.

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Paul Swinand - *Stephens Inc. - Analyst*

So in 2007, you would expect to maybe add the stores that flow in from 2006 that would give a little tail wind to the comp?

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

There is that possibility that we look forward to. We expect we can comp all of our stores over time. Again, with the merchandising initiatives that Rick talked about, the apparel upgrades and footwear upgrades and things that we're doing in all of our stores on top of this new effort, which is a front half effort of boats, marines and what that does, but the boat, marine and power sports is largely a big box set. So we look forward to that. And it may take us time, but we believe with the evidence that we've seen over the last couple of years that it exists.

Paul Swinand - *Stephens Inc. - Analyst*

Thank you very much.

Operator

Steve Denault, Northland Securities.

Steve Denault - *Northland Securities - Analyst*

Good afternoon everybody. I'm trying to get a sense -- how big is your advertising budget in the fourth quarter?

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

Go ahead, Bob. We don't normally break that out, but --.

Bob Vold - *Gander Mountain Company - CFO*

We really haven't broken out advertising dollars, I don't know, on any quarterly basis from that standpoint. From an overall standpoint, we expect our advertising dollars year-over-year to essentially be flat from a basis point standpoint, I mean, right in that same range. As Rick talked, we're going to continue to shift dollars between quarters. In part as we have more Southern stores to support the fishing season in the spring down there, as well as we have rolled out the power sports and the boat initiative in the South, we'll put some emphasis towards that as well.

Steve Denault - *Northland Securities - Analyst*

Okay. And I guess what I'm trying to home in on a little bit is again this store operating expense number. If you look at your -- on an absolute basis year-over-year, the store count being up, call it 7%, but the store operating expense is up 25%. I can't quite reconcile that myself. Is there something within there, a certain line item, that drove that?

Bob Vold - *Gander Mountain Company - CFO*

It's really the two factors that we referred to earlier. Again, it's advertising and then labor costs.

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Mark Baker - Gander Mountain Company - President and CEO

As you might imagine, it's no surprise in any retailer, particularly a specialty retailer, that December is a big line item month, the biggest obviously. And we will get leverage on the year and sometimes throughout either weather phenomena or investments that we made we believe would drive customer activity. In some cases, it doesn't show up for whatever reason and we believe primarily related to weather because we saw significant growth in our Southern stores because the activities were available to the consumers. You know this market, how warm it was across the Upper Midwest and what that can do to traffic and you still have to take care of those customers.

Bob Vold - Gander Mountain Company - CFO

We still leveraged store operating expenses year-over-year. I mean, it went from 19.2% to 18.4%, even in spite of what happened in quarter four.

Steve Denault - Northland Securities - Analyst

Okay, thank you.

Operator

(OPERATOR INSTRUCTIONS). Bob Simonson, William Blair.

Bob Simonson - William Blair - Analyst

Just a follow-up, Bob, on the -- I'm sure it was a long document, but the renegotiation of the credit line, can you highlight any specific changes that were either plus (indiscernible) [lenient] or restrictive?

Bob Vold - Gander Mountain Company - CFO

It's actually a relatively short agreement. Essentially, it takes the \$30 million net new cash, builds them into our covenants, reduces -- I mean, there's grid pricing, and we can use that \$30 million to reduce our pricing under the revolver. It's essentially anywhere where you fall on the grid, anywhere between a 25 and a 50 basis point improvement on the revolver, and a 125 basis point improvement on the term loan, which is \$20 million. The annual impact of -- estimated annual impact of the better pricing is close to \$1 million from an interest standpoint.

Bob Simonson - William Blair - Analyst

Did it change any of the covenants?

Bob Vold - Gander Mountain Company - CFO

It only built in the \$30 million to be able to be used for pricing purposes, and it used the \$30 million for the operating cash flow covenant (indiscernible) in a 12-month period.

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Bob Simonson - *William Blair - Analyst*

Okay. And two follow-ups on the Tracker. I think, Mark, you said it's going to -- is either in or will be in 34 stores this spring.

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

That's correct. Rick, how many stores is it in now?

Rick Vazquez - *Gander Mountain Company - EVP, Merchandising and Marketing*

We probably -- that rollout started in mid-February. We are in about 18 stores to date and continuing to add new stores every day until we will reach 34 by the end of April.

Bob Simonson - *William Blair - Analyst*

And is that on the 100 and some-odd stores you have now and the couple -- will it go in all of the new stores?

Rick Vazquez - *Gander Mountain Company - EVP, Merchandising and Marketing*

As market-specific and appropriate, yes. If it's not -- if the market does not support the business, we would not do that. But as we open stores where it is appropriate, we will.

Bob Simonson - *William Blair - Analyst*

In the existing 105, is there an opportunity to go past 34, or it's going to be 34 with full presentation?

Rick Vazquez - *Gander Mountain Company - EVP, Merchandising and Marketing*

Divide that two ways, Bob. In the existing stores, there will be some opportunities beyond the 34 that we have it in. In fact, we have another three or four stores that already carry full lines of boats, just not the Tracker brand and there's several reasons for that situation. So there is opportunity to do more of that. But what is also exciting is that in our small format stores, just the ability to sell loose john boats and loose motors is a big deal to us, and that's something that's going to be -- that is a great market for every one of our stores.

Bob Simonson - *William Blair - Analyst*

Following up on somebody else's question is -- can you comment as to whether the margin on Tracker sales should be higher or lower or the same as the store average currently?

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

Certainly, Bob, the Tracker boats direct are going to have a lower margin rate than the Company as a whole.

Bob Simonson - *William Blair - Analyst*

On an operating basis, not just a gross?

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Mark Baker - Gander Mountain Company - President and CEO

That's correct, but we want to make sure that you understand that what it does to the scale of the business, what it does to drive for the overall halo of the business. And after having tested this for a couple of years, we have enough evidence to say, this is accretive to our overall business. And again, we will break it out of it becomes necessary so that we can look at our margins from a merchandising side separately.

Bob Simonson - William Blair - Analyst

Very good, thanks a lot.

Operator

There are no further questions at this time. I will turn the conference back over to Mr. Baker for any additional or closing remarks.

Mark Baker - Gander Mountain Company - President and CEO

Thanks everyone for attending this call. Overall, our vision remains intact and we're developing scale of business with the ability to grow toward our long-term goals -- over \$3 billion in revenues and 5% to 6% operating margin and double-digit ROIC. Gander Mountain will be the best outdoor lifestyle retailer as we grow toward a network of more than 300 stores. I want to thank our associates for handling over 15 million customer transactions, a record number for the year. They are the real drivers of our success -- thank you. Thanks for joining us today. We'll speak to you again in a couple of months.

Operator

That does conclude the conference call for today. We thank you for your participation, you may now disconnect.

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