

2006 SMITH & WESSON ANNUAL REPORT

# Financial Highlights

## Earnings Per Share




## Net Product Sales (In millions)




## Pre-tax Income (In millions)




## Total Debt (In millions)






**Dear Stockholders:**

Fiscal 2006 was a year of accomplishment at Smith & Wesson, culminating in positive financial results, growth in our core handgun business, diversification into new markets with innovative new products, and increased stockholder value.

We established record-level highs for our company in annual revenue and operating profit. Net product sales of $157.9 million in fiscal 2006 grew 27% over fiscal 2005. Sales of our core firearms products, supported by a number of sales and marketing initiatives, grew 29.8%, reflecting a 69.0% increase in pistol sales and a 13.7% increase in revolver sales. Income from operations in fiscal 2006 increased by 30% over fiscal 2005, and we delivered annual diluted earnings per share in fiscal 2006 of $0.22, versus $0.14 in fiscal 2005, a 57% increase.

We secured our first major order in 15 years from the U.S. government. During the course of the year, we won $20 million in government business, totaling over 73,000 pistols for the Afghanistan National Police and Border Patrol. And despite federal export restrictions that we are working hard to change, we achieved growth of over 58% in international sales in fiscal 2006.

We maintained our commitment to innovation and to diversification in fiscal 2006 with the launch of our new M&P40 polymer pistol, designed for law enforcement professionals, and with our entry into the long gun market with our M&P15 tactical rifle. The response to these Military & Police series additions has been very positive, evidenced by continued strength in both law enforcement and consumer sales.

We kept our focus in Washington, increasing awareness of Smith & Wesson and capturing opportunities to improve the business environment for our industry and our Company. As a result, we had the honor of witnessing the signing of the Protection of Lawful Commerce in Arms Act by President Bush. This was a milestone that protects and strengthens the firearms industry and our Second Amendment rights.

Core to our strategy is to build on the power of our Smith & Wesson brand. We leveraged this asset in fiscal 2006 by refining our licensing portfolio and launching innovative marketing programs supporting sales in a variety of channels. From revolutionary DVD-based product support materials for our M&P pistols to our sponsorship of NASCAR, we are successfully re-energizing the Smith & Wesson name.



This year's accomplishments were capped with a proud event in February 2006 when Smith & Wesson was named Manufacturer of the Year at the NRA's Annual Convention. It was a great honor to win our industry's most prestigious award and we are proud that our dealers hold Smith & Wesson in such high regard.

Our focus in fiscal 2007 will remain fixed on making Smith & Wesson a leader in the global business of SAFETY, SECURITY, PROTECTION and SPORT. We will continue to visit Washington, driving legislative changes to create a more competitive position for our industry in international markets. We will drive growth in our core firearms business, fueled by increased sales into sporting goods, the law enforcement, federal government, and international markets and supported by a robust product portfolio expanded with new products we will launch in fiscal 2007. As we grow, we will work to enhance our profitability by continuing to secure operational improvements and cost reductions. We will continue to seek opportunities to diversify by entering new markets via internal manufacturing, outsourcing, licensing and acquisitions. As we assess these opportunities, we will keep a sharp eye toward profitable growth.

In fiscal 2006, we promised execution and diversification. We delivered on those commitments. On behalf of the entire Board of Directors, we wish to thank our employees for their dedication and their commitment to excellence, which produced our tremendous results in fiscal 2006 and provides the foundation to lead us to even better results in 2007.




Michael F. Golden, President and
Chief Executive Officer, Director

Barry Monheit, Chairman of the Board










For 154 years, Smith & Wesson has been a leader in innovation. This legacy has made us a leader in the U.S. market for handguns and will support our efforts to gain leadership in the global firearms and related markets as well. In fiscal 2006, a host of new products fueled growth in our sales into sporting goods retailers and to law enforcement.

The M&P Pistol Series features a polymer, reinforced frame and stainless steel barrel and slide for durability; a passive trigger safety to prevent the pistol from firing if dropped; and a unique trigger mechanism, which eliminates the need to press the trigger in order to disassemble the firearm. Other features include a loaded chamber indicator located on top of the slide and an optional internal locking system. The innovative, ergonomic design is enhanced with three interchangeable grip sizes, allowing the user to customize to their personal hand size. The firearm features an ambidextrous slide stop and magazine release, and an enlarged trigger guard to accommodate gloves. A universal Picatinny style equipment rail allows the addition of accessories.

**M&P Pistols**

The launch of the Military & Police™ Series of pistols, chambered in both .40 and 9 mm calibers, represents our newest entry in the pistol market with our unique, feature-rich polymer pistols. The M&P series was developed hand-in-hand with law enforcement professionals and was designed specifically to meet their demands. The result was a polymer pistol that is not only ambidextrous and ergonomically designed to offer a more effective shooting position, but one that also delivers a revolutionary feature, which eliminates the need to press the trigger in order to disassemble the firearm.

**M&P15 Series Tactical Rifles**

Tactical rifles represent the fastest growing segment in the long-gun market and provide an opportunity for our company to diversify. Long used by the military, sport hunters and competitive shooters, tactical rifles are also increasingly called for by law enforcement agencies to supplement or replace existing pump-action shotguns. Consumer feedback indicated that the Smith & Wesson brand name would be widely recognized and respected in the tactical rifle market. We expanded the Military & Police family in fiscal 2006 with the addition of our M&P15 tactical rifles. Both the M&P15 and M&P15A, along with the enhanced version, the M&P15T, are available today at retailers.

While innovation is key to our future, our existing portfolio of firearms continues to deliver what the market demands.



Sigma Polymer Pistol

**Sigma Pistol Series**

In fiscal 2006, the U.S. government selected our Sigma polymer pistol because it provides the performance features required in the extreme environmental conditions of Afghanistan. The Sigma is a double-action-only pistol constructed with a durable polymer frame and a through-hardened stainless steel slide and barrel. It features an ergonomic design and simple operating procedures. In fiscal 2006, we received four orders totaling 73,000 Sigma pistols for shipment to the Afghanistan National Police and Border Patrol.




**460XVR™**

In January 2005, we introduced the 460XVR revolver, which received the "2005 Handgun of the Year" award from the Shooting Industry Academy of Excellence. Our engineering team designed the 460XVR for the growing handgun hunting and shooting sports markets. The 460XVR is capable of launching a 200-grain bullet at over 2,300 feet per second, making it the highest velocity production revolver currently available. This revolutionary revolver continues to receive acclaim, and in May 2006 received the National Rifle Association's Golden Bullseye Award for "2006 Handgun of the Year."



**Law Enforcement**
In fiscal 2006, we supplemented our existing law enforcement sales team with additional personnel; experienced people with strong backgrounds in our industry. They had the right contacts, along with a firsthand knowledge of both professional firearms and the unique sales processes that exist in the law enforcement world. In several cases, they came from our competitors, choosing the Smith & Wesson team in part for the product innovation reflected in our M&P pistol products for law enforcement.

**Sporting Goods**
In mid-fiscal 2006, we reorganized our sporting goods sales team, replacing our manufacturers' representatives with direct sales employees. This team supports firearms dealers and distributors with sales and marketing programs to increase turnover on Smith & Wesson and Walther firearms. We made sure the people we hired came from within our industry, providing existing knowledge of territories and opportunities. The result was a dramatic increase in sales growth for every quarter after the transition. Sales growth in the sporting goods channel for both the first and second quarters was a steady 8%. We completed the transition at the end of our second quarter and, by focusing our efforts on training and supporting our dealers, delivered sales growth of 24% in the third quarter and 32% in the fourth quarter of fiscal 2006.




We supported our direct sales force with contemporary marketing programs and materials designed to increase awareness of Smith & Wesson and Walther at the point-of-purchase. We sponsored dealer incentives, and we supplied counter-top displays and DVD support materials for our innovative M&P polymer pistols. Insuring that our dealers are knowledgeable about Smith & Wesson and Walther products helps make sure that our firearms remain a visible and recommended choice for consumers.

**Federal Government**
Military sales to the U.S. government represent tremendous accomplishment for fiscal 2006 and a growing opportunity for years to come. In fiscal 2006, we hired sales leadership personnel with the firearms sales and management experience required to secure orders from our government. These efforts, combined with our increased presence in Washington, helped deliver four orders during the fiscal year from the federal government and created valuable awareness in Washington of our company's strong capabilities.



Early in fiscal 2006, we secured representation in Washington, not only to ensure safe passage of the Protection of Lawful Commerce in Arms Act (PLCAA) legislation to protect firearms manufacturers from frivolous lawsuits, but also to make the environment more favorable for U.S.-based firearms manufacturers. These efforts were successful, and we were proud to be part of the team that helped drive passage of the PLCAA. We are now focusing our efforts on raising export thresholds and encouraging our government to insure that domestic military agencies carry firearms made in the United States by an American company, so that the intellectual property and the jobs remain in our country.



**International**
In fiscal 2006, we grew our international business by more than 58% from the preceding year, with most of that growth coming from law enforcement customers. By reconfiguring our global sales network to strengthen our contacts with international military and police agencies, we were able to count among our customers the Royal Canadian Mounted Police, as well as the police forces of Japan, Korea, and Australia. We expect that our efforts in Washington to raise current export thresholds, combined with our new M&P9 polymer pistol offering, a caliber often preferred internationally, will build upon this growing part of our business in fiscal 2007.




**Cincinnati:**
The Cincinnati Police Department ordered 1,100 new Smith & Wesson M&P9 polymer pistols and chose the M&P rifle for use on duty. The M&P pistol incorporates key features valuable to their officers, including enhanced ergonomics and a magazine safety disconnect. The M&P9 was selected after an extensive testing and evaluation process.

**North Carolina Department of Correction:**
The North Carolina Department of Correction (NCDOC) ordered 5,700 of the company's new M&P pistols for its officers. NCDOC has been using Smith & Wesson firearms for over 30 years, and indicated that the M&P40's interchangeable grip panels enabled them to select one pistol that will fit any one of their 10,000 officers.

**Las Vegas Metropolitan Police Department:**
Shortly after unveiling our new M&P tactical rifles at our industry's SHOT Show, we began shipping initial units and received our first order for the Smith & Wesson M&P15 from the Las Vegas Metro Police Department (LVMPD). Officials at LVMPD indicated that the M&P15 would allow for better preparedness of it's officers when responding to a variety of situations.




Our growth throughout fiscal 2006 was supported with an innovative marketing approach aimed at a broader market than we have historically pursued. We sponsored NASCAR, the fastest growing spectator sport in the country, and we created advertisements designed to appeal to women and hunters.

**NASCAR**

Hunting and shooting sports are among the most popular hobbies of NASCAR racing fans, making NASCAR race venues a prime locale to promote awareness of the Smith & Wesson brand with existing and new consumers. In fiscal 2006, we sponsored eight NASCAR, Busch Series races, hosting a variety of trackside events and promoting the sale of Smith & Wesson branded merchandise.

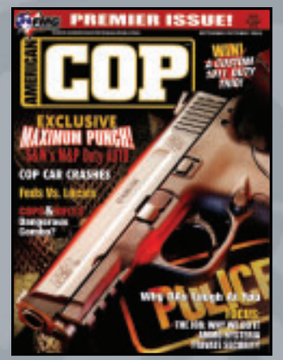






**Manufacturer of the Year Award**

In May 2006, we received the "Manufacturer of the Year" award from the Shooting Industry Academy of Excellence during the 135th NRA Annual Meeting. The Academy of Excellence is sponsored by FMG Publications, publisher of *Shooting Industry*, *GUNS*, *American Cop*, and *American Handgunner* magazines and consists of 471 industry executives, firearms dealers, and outdoor writers. We were nominated for the award for introducing 43 new products; re-introducing several historic firearms; continuing to support and expand shooting sports through various programs; driving innovative sales and marketing initiatives; and supporting passage of the PLCAA.



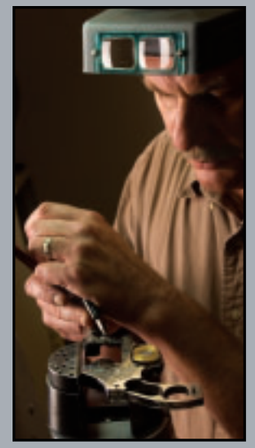








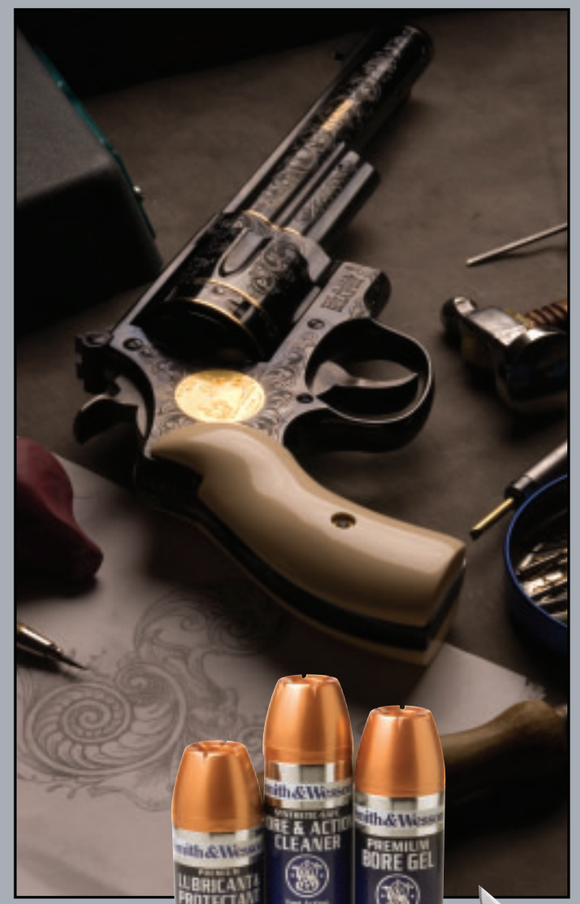







**Commemoratives**

The brand loyalty enjoyed by the Smith & Wesson name can be seen in the revenue generated from the sale of commemorative firearms, including engraved revolvers and pistols. Our engraving business grew over 250% in fiscal 2006 to $6 million. Notable among our commemoratives was the 50th Anniversary Edition of the Model 29 .44 Magnum, the revolver made famous by Clint Eastwood's movie character "Dirty Harry," and the 75th Anniversary Edition of the Walther PPK made famous by Ian Fleming's James Bond character.





**Licensing**

Because we are one of the oldest and most respected American brands, we continually seek to build brand loyalty through our licensing partnerships. We select licensees that operate within related industry categories, those that expand affinity for our Smith & Wesson brand, and those that allow us to explore new categories within safety, security, protection and sport. In fiscal 2006, we refined our licensee portfolio, adding five new licensees, including licensees for products in gun cleaning equipment and products, safes, and apparel.





**Manufacturing Focus**

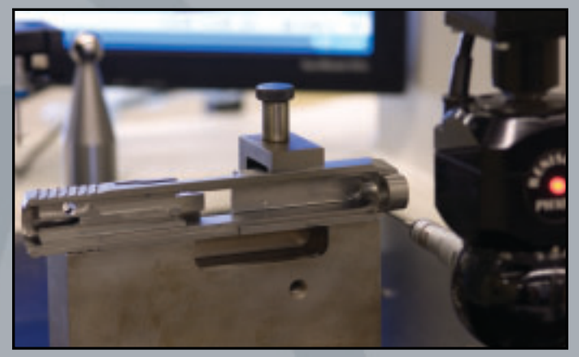
Implementation of the Smith & Wesson Operating System, based on Toyota's Production System, guided our investments in technology and our operational improvements throughout the factory in fiscal 2006. These enhancements helped us increase profits, and provided capacity to allow for our continued growth.

The key accomplishments in our pistol business were the launch of our new M&P polymer pistol line, along with the addition of capacity to support four sizeable orders from the U.S. government for our Sigma pistols. In response to increased demand, we invested in new technology in the form of new machining cells that reduced our slide manufacturing process from fifteen steps to three, and machining centers that reduced our barrel manufacturing process from thirteen steps to only four. Where feasible, we also shifted from using fully machined parts to using metal injection-molded components. Across the board, our investments helped to improve product quality and reduce costs.

Our revolvers are world-renowned for their outstanding quality and craftsmanship. In fiscal 2006, continuing growth combined with demand for our award-winning 460XVR drove us to find new ways to increase output by enhancing the capability of our existing equipment. Through the use of the Smith & Wesson Operating System, we were able to make significant improvements in quality, output and delivery. In fact, our efforts resulted in machine uptime improvements from 58% to over 80% by the end of fiscal 2006.



**Slide manufacturing process:** A single steel bar is machined to a finished pistol slide.



Our ability to make these tremendous strides in operational efficiency is due largely to the skill, dedication and enthusiasm of the men and women who continue to make our products legendary. In fiscal 2006, they seized the unique opportunity to explore blending old-world craftsmanship with new technology. As a result, we were able to increase revolver production by 15%, and pistol production by over 60%, while we continued to make some of the most highly regarded firearms in the world.








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