



ELLUMINATION

October 30, 2007

SMITH & WESSON MISFIRES!

At the close of trading last night shares of Smith & Wesson Holding Corp (SWHC) were \$20.09 apiece. They closed tonight at \$12.12. That is a huge drop of over 39% in one day. We rarely see one-day declines like that. Since SWHC is held in five of the six model portfolios I thought it was my responsibility to notify you and offer an explanation as to what happened. The bottom line is that SWHC announced last night that they will be coming up short on their previously announced earnings and revenue forecasts. Here is the text of the Associated Press coverage of the announcement released yesterday afternoon:

SPRINGFIELD, Mass. (AP) -- Gun maker Smith & Wesson Holding Corp. on Monday reported preliminary second-quarter income below analyst estimates, and reduced its outlook for the full year.

Smith & Wesson expects to report earnings of 5 cents per share to 7 cents per share for the second fiscal quarter ending Oct. 31, compared with earnings of 7 cents per share in the comparable year-ago period. The company expects revenue to grow by 36 percent to 40 percent, to a range of \$69 million to \$71 million.

Analysts polled by Thomson Financial expect earnings of 12 cents per share on revenue of \$82.4 million.

Smith & Wesson lowered its full-year profit guidance to \$23.5 million, or 53 cents per share, from a previous outlook of \$28.5 million, or 63 cents per share. The company expects full-year revenue of \$325 million, versus a previous outlook of \$330 million.

Analysts polled by Thomson Financial expected full-year earnings of 64 cents per share on revenue of \$334.9 million, on average. Current guidance represents a 81 percent increase in profit and a 38 percent increase in revenue, Smith & Wesson said.

Results in the second quarter were hurt by "softness in the market for hunting rifles and shotguns, driven by lower than expected consumer demand, a buildup of pre-season retail inventories, and unseasonably warm autumn weather, which decreased retail traffic and compressed the fall hunting season," Chief Executive Michael Golden said in a statement.

The company expects to increase promotional spending, which will hurt gross profit margins. Smith & Wesson now expects full-year gross margins of 33.5 percent to 34.5 percent, below its previous guidance of 35 percent to 36 percent but higher than fiscal 2007 gross margins of 32.3 percent.

NOW LET ME OFFER SOME GOOD NEWS AND COMFORT

During the past two months K&A has been reducing the size of this position in all 5 models. We made a decision a couple of months ago that the stock was "getting ahead of itself". In our jargon that simply means that while we still believe in the company and its "turn around" story there are simply too many "momentum" players jumping on board and buying the stock. The markets have really changed over the past few years and there are lots of "trades" put on every day through technical or quantitative or momentum analysis that have absolutely nothing to do with buying a stock because of the quality of the business. The stock gets bought because it satisfies some analytical parameter that fits within a technical, quantitative or momentum system of trading. The

“cause & effect” is that prices go up so long as these buyers are active and prices have the possibility of turning around sharply if they decide to exit a position. If all of them head to the exit at one time it is now possible to see the kind of collapse you saw today in SWHC. Frankly, this just didn’t happen in decades past. Price action like this is all thanks to various trading signals coupled with instantaneous high-speed computerized trading, etc. But wait; I digress.

In any event, the price of SWHC seemed to be accelerating upward because more and more buyers who fit into one or more of these categories were buying it; and therefore driving the price upward, rather than the price moving up in response to fundamental quality of business developments at SWHC.

Therefore we took the following action:

1) **Hatteras Model Account:** During September and October we sold off approximately 45% of the shares that were held in the model as of the end of August. These sales were at average prices of \$19.95 per share. The average cost of those shares was \$8.40 apiece. The bottom line is that we reduced the position by 45% and had a long-term gain of 137.50% on those shares that were sold.

As of tonight the remaining shares in the Hatteras Model Account, which comprise approximately 55% of the original position size, have an average cost of purchase of \$10.29 and are valued at the close at \$12.23.

2) **Mendocino Model Account:** During September and October we sold off approximately 40% of the shares that were held in the model as of the end of August. These sales took place at an average price of \$19.98 per share. The average cost of the shares was \$8.39. The bottom line is that we reduced the position by 40% and had a long term gain of 138.14% on those shares that were sold.

As of tonight the remaining shares in the Mendocino Model Account, which comprise about 60% of the original position size, have an average cost of purchase of \$10.28 and are valued at the close at \$12.23.

3) **Fresnel Model Account:** During September and October we sold off approximately 54% of the shares that were held in the model as of the end of August. These sales took place at an average price of \$20.02 per share. The average cost of the shares was \$8.49. The bottom line is that we reduced the position by 54% and had a long term gain of approximately 136% on those shares that were sold.

As of tonight the remaining shares in the Fresnel Model Account, which comprise about 46% of the original position size, have an average cost of purchase of \$10.32 and are valued at the close at \$12.23.

4) **Bonavista Model Account:** During September we sold off approximately 32% of the shares that were held in the model as of the end of August. These sales took place at an average price of \$19.48 per share. The average cost of the shares was \$11.81. The bottom line is that we reduced the position by approximately 32% and had a gain of 64.94% on the shares that were sold. The reason for the significantly smaller gain for Bonavista than the three previous models is that original shares were acquired for this model later than for the three previously mentioned models, and at a higher cost basis.

As of tonight the remaining shares in the Bonavista Model Account, which comprise about 68% of the original position size, have an average cost of purchase of \$11.84 and are valued at the close at \$12.23.

5) **Halifax Model Account:** During September we sold off approximately 46% of the shares that were held in the model as of the end of August. These sales took place at an average price of \$19.99 per share. The average cost of the shares was \$12.25. The bottom line is that we reduced the position by approximately 46% and had a gain of 63.18% on the shares that were sold. This model is similar to Bonavista in that the shares were purchased for Halifax and Bonavista later than for the three previously mentioned models and at a higher cost basis.

As of tonight the remaining shares in the Halifax Model Account, which comprise about 54% of the original position size, have an average cost of purchase of \$11.18 and are valued at the close at \$12.23.

That is a very long way of telling you that regardless of which model we are examining, ALL the total investments in SWHC, in these examples, are VERY profitable despite what happened today. If you have an account that is managed by K&A according to one of these models your results will be very similar.

I have never said this before in one of our newsletters, but I am going to say it now. If you have an account at K&A that is NOT in one of our models, you should talk to Rob, or Lee, or me about how to make your account consistent with one of the six models.

All of the detail of these transactions will be provided to account holders at year end on your 1099.

WHAT IS K&A'S TAKE ON ALL OF THIS?

The markets reaction to the earnings shortfall and revenue guidance was emphatic and resounding. The stock lost almost 40% of its value in one day. There is no arguing with that fact and nothing we can do about it now. Our "take" is that this "correction" was DRAMATICALLY overdone and that SWHC just went from being a "momentum" stock that had probably gotten ahead of itself and therefore was probably overpriced to being a "value" stock that is now available at bargain basement prices and should be bought.

We will wait a few days and continue monitoring the reaction of the market to this news from SWHC. Unfortunately when things like this happen there is often further downside over the next couple of days following the first dramatic fall in price. That simply happens because there are always people who bought the stock for the wrong reason; froze when the going got tough and didn't sell; and then wake up the next day and ask themselves what the heck just happened to them. Then they sell. Brilliant, right?

We are still very comfortable with the ongoing turnaround story at SWHC. They are still forecasting very solid earnings and revenue growth. They are making significant inroads to the military and police markets. They are an extremely well run company.

We think that patience is likely to be a virtue with SWHC and we are hopeful that 12-18 months from now the stock price will fully recover to \$20 or more.

In the meantime we are very happy that we booked some profits on a large portion of the original holdings. We like the fact that we are still profitable on all the shares that remain in the models even after this drubbing. We will keep you apprised of new developments.

"The bottom line", as I seem to say a lot, is that while this "hit" took a toll on all 5 models today our overall trades for SWHC within the models are extremely successful and the models themselves are doing great.

As we have started to say around here we are, "kicking the ____ out of the markets this year".

We are doing everything we know to keep it up, including trimming back positions that have gotten ahead of themselves.

All the best,

Paul Krsek
For K&A Asset Management, LLC

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K&A manages accounts with various histories and investment objectives. Various accounts may be managed differently from time to time.

Krsek makes frequent reference to the model portfolios called Hatteras, Mendocino, Halifax, Bonavista, Fresnel and The New World. During 2005 Paul Krsek was appointed Chief Investment Officer of K&A, and as such is responsible to make all trading and management decisions for all client accounts which are being managed according to a specific portfolio model. A description of each of our models can be found on our website at <http://www.kaassets.com/choices.htm>.

Not all accounts managed by K&A are "modeled" accounts. We strongly urge our clients to understand which model, if any, are being used to manage their accounts.

As of July 3, 2007 Lee O'Dwyer joined K&A as a portfolio manager. Paul Krsek and Lee O'Dwyer frequently discuss investment ideas, model portfolio strategies and the investment policies of K&A. But when it comes to the implementation of those policies Krsek is primarily responsible to manage the accounts that fit into each model portfolio description. He generally makes all final investment and trading decisions relative to those accounts that are considered to be "modeled." However, in Krsek's absence O'Dwyer does have the authority to trade all client accounts. He has been actively trading accounts in the various models since joining K&A.

From time to time K&A receives requests from clients to purchase securities that are not included in the model portfolio to which they are assigned. Effective May 24, 2006 K&A has encouraged clients to hold such securities in a separate account for the client. Because K&A is a "fee only" registered investment advisor" it charges its normal management fee for monitoring such securities in the separate accounts in which they are held.

K&A makes every effort to exclude securities that are 'requested by the client' from the modeled portfolio accounts.

The investment objectives of various accounts and models may be substantially different from one another. Therefore topics or investments mentioned in E-Illumination may or may not apply to specific managed accounts and/or models.

Trades or adjustments to accounts mentioned in ELLUMINATION may or may not happen in every account managed by portfolio managers at K&A.

If you are not satisfied with the investment results in your account it is your responsibility to inform Krsek or Andreae and to discuss possible changes that can be made to the account to accommodate and satisfy your needs.

The assets held in managed accounts at K&A Asset Management, LLC may include stocks, bonds, cash, commodities, foreign exchange or mutual funds or exchange traded funds (ETF's), money market accounts or limited partnerships that represent the same. They are subject to market fluctuation and the potential for losses. The assets are not insured. The value and income produced by these investment products may fluctuate, so that an investor may get back less than they initially invested.

The portfolio managers at K&A Asset Management, LLC do not guarantee results.

Past performance should not be considered an indicator of potential future performance. If you do not consider yourself suitable, either emotionally or financially, to experience volatility and/or losses in financial markets, you should not invest.

From time to time Krsek lists the simple annual returns of the six model accounts in this newsletter. These accounts are "models" and do not represent the actual results accruing to individual accounts. Simple annual return does not represent "time weighted return" as reported individually to clients in their quarterly reports prepared using Centerpiece.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy any securities or other instruments mentioned in it.

Sincerely,

Paul Krsek

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