STURM RUGER & CO INC
Form 10-Q
May 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

____

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from_______________ to _______________

Commission file number 1-10435

STURM, RUGER & COMPANY, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	06-0633559 (I.R.S. employer identification no.)
Lacey Place, Southport, Connecticut (Address of principal executive offices)	06890 (Zip code)

(203) 259-7843

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer”, and “smaller reporting company” in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer o Non-accelerated filer o Smaller reporting company o

o If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The number of shares outstanding of the issuer's common stock as of April 30, 2018: Common Stock, $1 par value –17,444,901.

Page 1 of 32

INDEX

STURM, RUGER & COMPANY, INC.

PART I. FINANCIAL INFORMATION

2

Index

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

STURM, RUGER & COMPANY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	March 31, 2018	December 31, 2017 (Note)
Assets		
Current Assets		
Cash	$ 102,667	$ 63,487
Trade receivables, net	61,129	60,082
Gross inventories	73,762	87,592
Less LIFO reserve	(45,312)	(45,180)
Less excess and obsolescence reserve	(2,338)	(2,698)
Net inventories	26,112	39,714
Prepaid expenses and other current assets	2,985	3,501
Total Current Assets	192,893	166,784
Property, plant and equipment	359,490	365,013
Less allowances for depreciation	(262,381)	(261,218)
Net property, plant and equipment	97,109	103,795
Other assets	13,273	13,739
Total Assets	$ 303.275	$ 284,318

Note:

The consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

See notes to condensed consolidated financial statements.

Index

STURM, RUGER & COMPANY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

(Dollars in thousands, except per share data)

	March 31, 2018	December 31, 2017 (Note)
Liabilities and Stockholders' Equity		
Current Liabilities		
Trade accounts payable and accrued expenses	$28,161	$32,422
Contract liability to customers (Note 3)	9,308	—
Product liability	667	729
Employee compensation and benefits	15,755	14,315
Workers' compensation	5,498	5,211
Income taxes payable	4,625	—
Total Current Liabilities	64,014	52,677
Product liability	82	90
Deferred income taxes	658	1,402
Contingent liabilities – Note 12	—	—
Stockholders' Equity		
Common Stock, non-voting, par value $1:		
Authorized shares 50,000; none issued	—	—
Common Stock, par value $1:		
Authorized shares – 40,000,000		
2018 – 24,110,299 issued, 17,444,901 outstanding	24,110	24,092
2017 – 24,092,488 issued, 17,427,090 outstanding		
Additional paid-in capital	28,737	28,329
Retained earnings	329,269	321,323
Less: Treasury stock – at cost		
2018 – 6,665,398 shares	(143,595)	(143,595)
2017 – 6,665,398 shares		
Total Stockholders' Equity	238,521	230,149
Total Liabilities and Stockholders' Equity	$303,275	$284,318

Note:

The consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

See notes to condensed consolidated financial statements.

Index

STURM, RUGER & COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended March 31, 2018	April 1, 2017
Net firearms sales	$129,883	$ 166,365
Net castings sales	1,276	990
Total net sales	131,159	167,355
Cost of products sold	95,339	111,602
Gross profit	35,820	55,753
Operating expenses:		
Selling	8,337	13,539
General and administrative	8,887	8,343
Total operating expenses	17,224	21,882
Operating income	18,596	33,871
Other income:		
Interest expense, net	(27)	(34)
Other income, net	332	354
Total other income, net	305	320
Income before income taxes	18,901	34,191
Income taxes	4,637	11,967
Net income and comprehensive income	$14,264	$ 22,224
Basic earnings per share	$0.82	$ 1.22
Diluted earnings per share	$0.81	$ 1.21
Cash dividends per share	$0.23	$ 0.44

See notes to condensed consolidated financial statements.

Index
STURM, RUGER & COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2017	$24,092	$28,329	$321,323	$(143,595)	$230,149
Net income and comprehensive income			14,264		14,264
Dividends paid			(4,012)		(4,012)
Unpaid dividends accrued			(79)		(79)
Adoption of ASC 606 (Note 3)			(2,227)		(2,227)
Recognition of stock-based compensation expense		1,144			1,144
Vesting of RSU's		(718)			(718)
Common stock issued-compensation plans	18	(18)			—
Balance at March 31, 2018	$24,110	$28,737	$329,269	$(143,595)	$238,521

See notes to condensed consolidated financial statements.

Index
STURM, RUGER & COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Three Months Ended	
	March 31, 2018	April 1, 2017
Operating Activities		
Net income	$ 14,264	$ 22,224
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	8,172	9,326
Slow moving inventory valuation adjustment	360	615
Stock-based compensation	1,144	686
Loss on sale of assets	—	31
Deferred income taxes	(744)	933
Changes in operating assets and liabilities:		
Trade receivables	(1,047)	(8,151)
Inventories	13,242	(1,038)
Trade accounts payable and accrued expenses	(3,974)	(2,693)
Contract liability to customers	7,081	—
Employee compensation and benefits	1,361	(9,873)
Product liability	(70)	(453)
Prepaid expenses, other assets and other liabilities	898	(3,165)
Income taxes payable and prepaid income taxes	4,625	10,495
Cash provided by operating activities	45,312	18,937
Investing Activities		
Property, plant and equipment additions	(1,402)	(7,232)
Cash used for investing activities	(1,402)	(7,232)
Financing Activities		
Remittance of taxes withheld from employees related to share-based compensation	(718)	(2,492)
Repurchase of common stock	—	(53,469)
Dividends paid	(4,012)	(7,772)
Cash used for financing activities	(4,730)	(63,733)
Increase (decrease) in cash and cash equivalents	39,180	(52,028)
Cash and cash equivalents at beginning of period	63,487	87,126
Cash and cash equivalents at end of period	$ 102,667	$ 35,098

See notes to condensed consolidated financial statements.

Index

STURM, RUGER & COMPANY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(Dollars in thousands, except per share)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements include all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the results of the interim periods. Operating results for the three months ended March 31, 2018 may not be indicative of the results to be expected for the full year ending December 31, 2018. These financial statements have been prepared on a basis that is substantially consistent with the accounting principles applied in our Annual Report on Form 10-K for the year ended December 31, 2017.

NOTE 2 - SIGNIFICANT ACCOUNTING POLICIES

Organization:

Sturm, Ruger & Company, Inc. (the "Company") is principally engaged in the design, manufacture, and sale of firearms to domestic customers. Approximately 99% of sales are from firearms. Export sales represent approximately 3% of total sales. The Company's design and manufacturing operations are located in the United States and almost all product content is domestic. The Company's firearms are sold through a select number of independent wholesale distributors, principally to the commercial sporting market.

The Company also manufactures investment castings made from steel alloys and metal injection molding (“MIM”) parts for internal use in its firearms and for sale to unaffiliated, third-party customers. Less than 1% of sales are from the castings segment.

Principles of Consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition:

The Company recognizes revenue in accordance with the provisions of Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers* (“ASC 606”), which became effective January 1, 2018. Substantially all product sales are sold FOB (free on board) shipping point. Customary payment terms are 2% 30 days, net 40 days. Generally, all performance obligations are satisfied when product is shipped and the customer takes ownership and assumes the risk of loss. In some instances,

Index

sales include multiple performance obligations. The most common of these instances relates to sales promotion programs under which downstream customers are entitled to receive no charge products based on their purchases of certain of the Company's products from the independent distributors. The fulfillment of these no charge products is the Company's responsibility. In such instances, the Company allocates the revenue of the promotional sales based on the estimated level of participation in the sales promotional program and the timing of the shipment of all of the firearms included in the promotional program, including the no charge firearms. Revenue is recognized proportionally as each performance obligation is satisfied, based on the relative customary price of each product. Customary prices are generally determined based on the prices charged to the independent distributors. The net change in contract liabilities for a given period is reported as an increase or decrease to sales.

Fair Value of Financial Instruments:

The carrying amounts of financial instruments, including cash, accounts receivable, accounts payable and accrued liabilities, approximate fair value due to the short-term maturity of these items.

Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications:

Certain prior period balances have been reclassified to conform to current year presentation.

Recent Accounting Pronouncements:

In May 2014, the FASB issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers (Topic 606)* which supersedes nearly all existing revenue recognition guidance. As more fully discussed in Note 3, the Company adopted ASC 606 using the modified retrospective method on January 1, 2018.

On March 30, 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation (Topic 718)*. The most significant change in the new compensation guidance is that all excess tax benefits and tax deficiencies (including tax benefits of dividends) on share-based compensation awards should be recognized in the Statement of Income as income tax expense. Previously such benefits or deficiencies were recognized in the Balance Sheet as adjustments to additional paid-in capital. The new guidance was effective in fiscal years beginning after December 15, 2016 and interim periods thereafter. The Company adopted ASU 2016-09 in the first quarter of 2017. Adopting this change in accounting principle reduced the Company's effective tax rate by 2% for the period ending September 30, 2017. This did not have a material impact on the Company's results of operations or financial position.

On February 25, 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, its long-awaited final standard on the accounting for leases. The most significant change in the new lease guidance requires lessees to recognize right-of-use assets and lease liabilities for all leases other than those that meet the definition of short-term leases. For short-term leases, lessees may elect an accounting policy by class of underlying asset under which these assets and liabilities are not recognized and lease payments are generally recognized over the lease term on a straight-line basis. This change will result in lessees recognizing right-of-use assets and lease liabilities for most leases currently accounted for as

Index

operating leases under legacy U.S. GAAP. The new lease guidance is effective in fiscal years beginning after December 15, 2018 and interim periods thereafter. Early application is permitted for all entities. The Company is currently evaluating the effect that the standard will have on the consolidated financial statements.

NOTE 3 – REVENUE RECOGNITION AND CONTRACTS WITH CUSTOMERS

On January 1, 2018, the Company adopted ASC 606, *Revenue from Contracts with Customers*, using the modified retrospective method, applied to those contracts for which all performance obligations were not completed as of that date. Under the modified retrospective method results for reporting periods beginning after January 1, 2018 will be presented using the guidance of ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with the previous guidance provided in ASC Topic 605, *Revenue Recognition*.

The effects of adjustments to the December 31, 2017 consolidated balance sheet for the adoption of ASC 606 were as follows:

	Balance at December 31,2017	Topic 606 Adjustments	Opening Balance January 1, 2018
Trade accounts payable and accrued expenses	32,422	(4,000)	28,422
Deferred revenue from contracts with customers	—	6,950	6,950
Deferred taxes	1,402	(723)	679
Retained earnings	321,323	(2,227)	319,096

At December 31, 2017, the Company had accrued $4.0 million related to certain of its sales promotion activities that included the shipment of no charge firearms. Using the new accounting guidance, a deferred contract liability of $6.9 million was required at December 31, 2017 and an entry for $2.9 million to increase the deferred contract liability, increase deferred tax assets by $0.7 million, and reduce beginning retained earnings by $2.2 million was recorded on January 1, 2018 (the “transition entry”).

The impact of the adoption of ASC 606 on revenue recognized during the quarter ended March 31, 2018 is as follows:

Contract liabilities with customers at January 1, 2018	$6,950
Revenue recognized	(4,822)
Revenue deferred	7,180
Contract liabilities with customers at March 31, 2018	$9,308

During the three months ended March 31, 2018, The Company deferred an additional $7.2 million of revenue, partially offset by the recognition of $4.8 million of revenue previously deferred as the performance obligation relating to the shipment of free products was satisfied. This resulted in a net reduction in firearms sales for the quarter of $2.4 million and a deferred contract revenue liability at March 31, 2018 of $9.3 million. The Company estimates that revenue from this deferred contract liability will be recognized in the second and third quarters of 2018. As a result of the adoption of ASC

10

Index

606, gross margin was reduced by approximately 3% and earnings per share was reduced by approximately 4¢.

Practical Expedients and Exemptions

The Company has elected to account for shipping and handling activities that occur after control of the related product transfers to the customer as fulfillment activities and are therefore recognized upon shipment of the goods.

NOTE 4 - INVENTORIES

Inventories are valued using the last-in, first-out (LIFO) method. An actual valuation of inventory under the LIFO method can be made only at the end of each year based on the inventory levels and costs existing at that time. Accordingly, interim LIFO calculations must necessarily be based on management's estimates of expected year-end inventory levels and costs. Because these are subject to many factors beyond management's control, interim results are subject to the final year-end LIFO inventory valuation.

During the three month period ended March 31, 2018, inventory quantities were reduced. If this reduction remains through year-end, it will result in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the current cost of purchases. Although the effect of such a liquidation cannot be precisely quantified at the present time, management believes that if a LIFO liquidation occurs in 2018, the impact may be material to the Company’s results of operations for the period but will not have a material impact on the financial position of the Company.

Inventories consist of the following:

	March 31, 2018	December 31, 2017
Inventory at FIFO		
Finished products	$ 12,404	$ 22,558
Materials and work in process	61,358	65,034
Gross inventories	73,762	87,592
Less: LIFO reserve	(45,312)	(45,180)
Less: excess and obsolescence reserve	(2,338)	(2,698)
Net inventories	$ 26,112	$ 39,714

NOTE 5 - LINE OF CREDIT

The Company has a $40 million revolving line of credit with a bank. This facility terminates on June 15, 2018. Borrowings under this facility bear interest at LIBOR (2.663% at March 31, 2018) plus 200 basis points. The Company is charged three-eighths of a percent (0.375%) per year on the unused portion. At March 31, 2018 and December 31, 2017, the Company was in compliance with the terms and covenants of the credit facility, which remains unused.

NOTE 6 - EMPLOYEE BENEFIT PLANS

The Company sponsors a 401(k) plan that covers substantially all employees. The Company matches a certain portion of employee contributions using the safe harbor guidelines contained in the

Index

Internal Revenue Code. Expenses related to these matching contributions totaled $0.8 million and $1.0 million for the three ended March 31, 2018 and April 1, 2017, respectively. The Company plans to contribute approximately $2.4 million to the plan in matching employee contributions during the remainder of 2018.

In addition, the Company provided supplemental discretionary contributions to the 401(k) plan totaling $1.3 million and $1.9 million for the three months ended March 31, 2018 and April 1, 2017, respectively. The Company plans to contribute approximately $4.0 million in supplemental contributions to the plan during the remainder of 2018.

NOTE 7 - INCOME TAXES

The Company's 2018 and 2017 effective tax rates differ from the statutory federal tax rate due principally to state income taxes. The Company’s effective income tax rate was 24.5% and 35.0% for the three months ended March 31, 2018 and April 1, 2017, respectively. This reduction is primarily the result of the Tax Cuts and Job Act of 2017, which reduced the statutory Federal tax rate from 35% to 21% effective January 1, 2018, partially offset by the loss of tax benefits available in the prior period related to the American Jobs Creation Act of 2004 that expired effective December 31, 2017. The reduced effective tax rate resulting from the Tax Cuts and Job Act of 2017 increased earnings per share by 11¢.

Income tax payments for the three months ended March 31, 2018 and April 1, 2017 totaled $0.0 million and $0.1 million, respectively.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years before 2015.

The Company does not believe it has included any “uncertain tax positions” in its federal income tax return or any of the state income tax returns it is currently filing. The Company has made an evaluation of the potential impact of additional state taxes being assessed by jurisdictions in which the Company does not currently consider itself liable. The Company does not anticipate that such additional taxes, if any, would result in a material change to its financial position.

NOTE 8 - EARNINGS PER SHARE

Set forth below is a reconciliation of the numerator and denominator for basic and diluted earnings per share calculations for the periods indicated:

	Three Months Ended	
	March 31, 2018	April 1, 2017
Numerator:		
Net income	$ 14,264	$ 22,224
Denominator:		
Weighted average number of common shares outstanding – Basic	17,432,829	18,219,557
Dilutive effect of options and restricted stock units outstanding under the Company’s employee compensation plans	203,226	168,554
Weighted average number of common shares outstanding – Diluted	17,636,055	18,388,111

12

Index

The dilutive effect of outstanding options and restricted stock units is calculated using the treasury stock method. There were no stock options that were anti-dilutive and therefore not included in the diluted earnings per share calculation.

NOTE 9 - COMPENSATION PLANS

In May 2017, the Company's shareholders approved the 2017 Stock Incentive Plan (the "2017 SIP") under which employees, independent contractors, and non-employee directors may be granted stock options, restricted stock, deferred stock awards, and stock appreciation rights, any of which may or may not require the satisfaction of performance objectives. Vesting requirements are determined by the Compensation Committee of the Board of Directors. The Company has reserved 750,000 shares for issuance under the 2017 SIP, of which 589,000 shares remain available for future grants as of March 31, 2018.

In April 2007, the Company adopted and the shareholders approved the 2007 Stock Incentive Plan (the "2007 SIP"), which had similar provisions as the 2017 SIP. The 2007 SIP plan expired April 24, 2017. The Company had reserved 2,550,000 shares for issuance under the 2007 SIP, of which 2,181,000 shares were issued.

Compensation costs related to all share-based payments recognized in the consolidated statements of income aggregated $1.1 million and $0.7 million for the three months ended March 31, 2018 and April 1, 2017, respectively.

Stock Options

A summary of changes in options outstanding under the 2007 SIP is summarized below:

	Shares	Weighted Average Exercise Price	Grant Date Fair Value
Outstanding at December 31, 2017	11,838	$ 8.95	$ 6.69
Granted	—	—	—
Exercised	—	—	—
Expired	—	—	—
Outstanding at March 31, 2018	11,838	$ 8.95	$ 6.69

The aggregate intrinsic value (mean market price at March 31, 2018 less the weighted average exercise price) of options outstanding under the 2007 SIP was approximately $0.5 million.

Restricted Stock Units

Beginning in 2009, the Company began granting performance-based and retention-based restricted stock units to senior employees in lieu of incentive stock options. The vesting of the

13

Index

performance-based awards is dependent on the achievement of corporate objectives established by the Compensation Committee of the Board of Directors and a three-year vesting period. The retention-based awards are subject only to the three-year vesting period.

There were 138,400 restricted stock units issued during the three months ended March 31, 2018. Total compensation costs related to these restricted stock units are $6.4 million. These costs are being recognized ratably over the vesting period of three years. Total compensation cost related to restricted stock units was $1.1 million and $0.7 million for the three months ended March 31, 2018 and April 1, 2017, respectively.

NOTE 10 - OPERATING SEGMENT INFORMATION

The Company has two reportable segments: firearms and castings. The firearms segment manufactures and sells rifles, pistols, and revolvers principally to a select number of independent wholesale distributors primarily located in the United States. The castings segment manufactures and sells steel investment castings and metal injection molding parts.

Selected operating segment financial information follows:

(in thousands)	Three Months Ended	
	March 31, 2018	April 1, 2017
Net Sales		
Firearms	$129,883	$ 166,365
Castings		
Unaffiliated	1,276	990
Intersegment	5,408	8,840
	6,684	9,830
Eliminations	(5,408)	(8,840)
	$131,159	$ 167,355
Income (Loss) Before Income Taxes		
Firearms	$19,130	$ 34,031
Castings	(488)	101
Corporate	259	59
	$18,901	$ 34,191
	March 31, 2018	December 31, 2017

Identifiable Assets		
Firearms	$187,943	$ 206,091
Castings	11,354	12,524
Corporate	103,978	65,703
	$303,275	$ 284,318

NOTE 11 – RELATED PARTY TRANSACTIONS

The Company contracts with the National Rifle Association (“NRA”) for some of its promotional and advertising activities, including the 2016 “Ruger $5 Million Match Campaign” and the

14

Index

2015-16 “2.5 Million Gun Challenge”. Payments made to the NRA in the three months ended March 31, 2018 and April 1, 2017 totaled $79,000 and $180,000, respectively. One of the Company’s Directors also serves as a Director on the Board of the NRA.

The Company has contracted with Symbolic, Inc. (“Symbolic”) to assist in its marketing efforts. Payments made to Symbolic during the three months ended March 31, 2018 totaled $22,000. During the three months ended April 1, 2017, the Company paid Symbolic $0.6 million, which amounts included $0.4 million for the reimbursement of expenses paid by Symbolic on the Company’s behalf. Symbolic’s principal and founder was named the Company’s Vice President of Marketing in June 2017, and remains a partner of Symbolic.

NOTE 12 - CONTINGENT LIABILITIES

As of March 31, 2018, the Company was a defendant in three (3) lawsuits and is aware of certain other such claims. The lawsuits fall into three categories: traditional product liability litigation, non-product litigation, and municipal litigation, discussed in turn below.

Traditional Product Liability Litigation

One of the three lawsuits mentioned above involves claims for damages related to an allegedly defective product due to its design and/or manufacture. This lawsuit stems from a specific incident of personal injury and is based on a traditional product liability theory such as strict liability, negligence and/or breach of warranty.

The Company management believes that the allegation in this case is unfounded, that the incident was unrelated to the design or manufacture of the firearm, and that there should be no recovery against the Company.

Non-Product Liability

David S. Palmer, on behalf of himself and all others similarly situated vs. Sturm, Ruger & Co. is a putative class-action suit filed in Florida state court on behalf of Florida consumers. The suit alleges breach of warranty and deceptive trade practices related to the sale of 10/22 Target Rifles. The Company filed an Answer denying all material allegations and a Motion to Strike the putative class representative’s claims. That motion remains pending.

Municipal Litigation

Municipal litigation generally includes those cases brought by cities or other governmental entities against firearms manufacturers, distributors and retailers seeking to recover damages allegedly arising out of the misuse of firearms by third-parties.

There is only one remaining lawsuit of this type, filed by the City of Gary in Indiana State Court in 1999. The complaint in that case seeks damages, among other things, for the costs of medical care, police and emergency services, public health services, and other services as well as punitive damages. In addition, nuisance abatement and/or injunctive relief is sought to change the design, manufacture, marketing and distribution practices of the various defendants. The suit alleges, among other claims, negligence in the design of products, public nuisance, negligent

Index

distribution and marketing, negligence per se and deceptive advertising. The case does not allege a specific injury to a specific individual as a result of the misuse or use of any of the Company's products.

After a long procedural history, the case was scheduled for trial on June 15, 2009. The case was not tried on that date and was largely dormant until a status conference was held on July 27, 2015. At that time, the court entered a scheduling order setting deadlines for plaintiff to file a Second Amended Complaint, for defendants to answer, and for defendants to file dispositive motions. The plaintiff did not file a Second Amended Complaint by the deadline.

In 2015, Indiana passed a new law such that Indiana Code §34-12-3-1 became applicable to the City's case. The defendants filed a joint motion for judgment on the pleadings, asserting immunity under §34-12-3-1 and asking the court to revisit the Court of Appeals' decision holding the Protection of Lawful Commerce in Arms Act inapplicable to the City's claims. The motion was fully briefed by the parties.

On September 29, 2016, the court entered an order staying the case pending a decision by the Indiana Supreme Court in *KS&E Sports v. Runnels,* which presents related issues. The Indiana Supreme Court decided *KS&E Sports* on April 24, 2017, and the *Gary* court lifted the stay. The *Gary* court also entered an order setting a supplemental briefing schedule under which the parties addressed the impact of the *KS&E Sports* decision on defendants' motion for judgment on the pleadings.

A hearing on the motion for judgment on the pleadings was held on December 12, 2017. On January 2, 2018, the Court entered an order dismissing the case in its entirety. The City filed a Notice of Appeal on February 1, 2018. The City’s appellate brief is due on or before May 23, 2018, with the defendants’ brief due 30 days thereafter.

Summary of Claimed Damages and Explanation of Product Liability Accruals

Punitive damages, as well as compensatory damages, are demanded in certain of the lawsuits and claims. In many instances, the plaintiff does not seek a specified amount of money, though aggregate amounts ultimately sought may exceed product liability accruals and applicable insurance coverage. For product liability claims made after July 10, 2000, coverage is provided on an annual basis for losses exceeding $5 million per claim, or an aggregate maximum loss of $10 million annually, except for certain new claims which might be brought by governments or municipalities after July 10, 2000, which are excluded from coverage.

The Company management monitors the status of known claims and the product liability accrual, which includes amounts for asserted and unasserted claims. While it is not possible to forecast the outcome of litigation or the timing of costs, in the opinion of management, after consultation with special and corporate counsel, it is not probable and is unlikely that litigation, including punitive damage claims, will have a material adverse effect on the financial position of the Company, but may have a material impact on the Company's financial results for a particular period.

Product liability claim payments are made when appropriate if, as, and when claimants and the Company reach agreement upon an amount to finally resolve all claims. Legal costs are paid as the lawsuits and claims develop, the timing of which may vary greatly from case to case. A time

16

Index

schedule cannot be determined in advance with any reliability concerning when payments will be made in any given case.

Provision is made for product liability claims based upon many factors related to the severity of the alleged injury and potential liability exposure, based upon prior claim experience. Because the Company's experience in defending these lawsuits and claims is that unfavorable outcomes are typically not probable or estimable, only in rare cases is an accrual established for such costs.

In most cases, an accrual is established only for estimated legal defense costs. Product liability accruals are periodically reviewed to reflect then-current estimates of possible liabilities and expenses incurred to date and reasonably anticipated in the future. Threatened product liability claims are reflected in the Company's product liability accrual on the same basis as actual claims; *i.e.*, an accrual is made for reasonably anticipated possible liability and claims handling expenses on an ongoing basis.

A range of reasonably possible losses relating to unfavorable outcomes cannot be made. However, in product liability cases in which a dollar amount of damages is claimed, the amount of damages claimed, which totaled $0.1 million and $0.1 million at December 31, 2017 and 2016, respectively, are set forth as an indication of the possible maximum liability the Company might be required to incur in these cases (regardless of the likelihood or reasonable probability of any or all of this amount being awarded to claimants) as a result of adverse judgments that are sustained on appeal.

NOTE 13 - SUBSEQUENT EVENTS

On May 8, 2018, the Company’s Board of Directors authorized a dividend of 32¢ per share, for shareholders of record as of May 22, 2018, payable on June 1, 2018.

The Company has evaluated events and transactions occurring subsequent to March 31, 2018 and determined that there were no other unreported events or transactions that would have a material impact on the Company’s results of operations or financial position.

Index

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Company Overview

Sturm, Ruger & Company, Inc. (the "Company") is principally engaged in the design, manufacture, and sale of firearms to domestic customers. Approximately 99% of sales are from firearms. Export sales represent approximately 3% of total sales. The Company's design and manufacturing operations are located in the United States and almost all product content is domestic. The Company's firearms are sold through a select number of independent wholesale distributors, principally to the commercial sporting market.

The Company also manufactures investment castings made from steel alloys and metal injection molding ("MIM") parts for internal use in its firearms and for sale to unaffiliated, third-party customers. Less than 1% of sales are from the castings segment.

Orders for many models of firearms from the independent distributors tend to be stronger in the first quarter of the year and weaker in the third quarter of the year. This is due in part to the timing of the distributor show season, which occurs during the first quarter.

Results of Operations

Demand

The estimated unit sell-through of the Company's products from the independent distributors to retailers decreased 5% in first quarter of 2018 from the comparable prior year period. For the same periods, the National Instant Criminal Background Check System ("NICS") background checks (as adjusted by the National Shooting Sports Foundation ("NSSF")) increased 1%. The decrease in estimated sell-through of the Company's products from the independent distributors to retailers is attributable to decreased overall consumer demand in the early stages of the first quarter of 2018, partially offset by increased demand in the latter part of the quarter.

Sales of new products, including the Pistol Caliber Carbine, the Mark IV pistols, the LCP II pistol, the EC9s pistol, the Security-9 pistol, and the Precision Rimfire Rifle, represented $37.2 million or 29% of firearm sales in the first quarter of 2018. New product sales include only major new products that were introduced in the past two years.

Estimated sell-through from the independent distributors to retailers and total adjusted NICS background checks for the trailing quarters follow:

	2018 Q1	2017 Q4	Q3	Q2	Q1
Estimated Units Sold from Distributors to Retailers (1)	509,500	425,600	341,300	362,400	533,800
Total adjusted NICS Background Checks (thousands) (2)	3,731	4,210	2,948	3,116	3,694

18

Index

(1) The estimates for each period were calculated by taking the beginning inventory at the distributors, plus shipments from the Company to distributors during the period, less the ending inventory at distributors. These estimates are only a proxy for actual market demand as they:

- Rely on data provided by independent distributors that are not verified by the Company,
- Do not consider potential timing issues within the distribution channel, including goods-in-transit, and
- Do not consider fluctuations in inventory at retail.

(2) NICS background checks are performed when the ownership of most firearms, either new or used, is transferred by a Federal Firearms Licensee. NICS background checks are also performed for permit applications, permit renewals, and other administrative reasons.

The adjusted NICS data presented above was derived by the NSSF by subtracting out NICS checks that are not directly related to the sale of a firearm, including checks used for concealed carry ("CCW") permit application checks as well as checks on active CCW permit databases.

Orders Received and Ending Backlog

The Company uses the estimated unit sell-through of our products from the independent distributors to retailers, along with inventory levels at the independent distributors and at the Company, as the key metrics for planning production levels. The Company generally does not use the orders received or ending backlog for planning production levels.

The units ordered, value of orders received and ending backlog, net of excise tax, for the trailing five quarters are as follows (dollars in millions, except average sales price):

(All amounts shown are net of Federal Excise Tax of 10% for handguns and 11% for long guns.)

	2018 Q1	2017 Q4	Q3	Q2	Q1
Units Ordered	635,900	467,500	221,900	214,400	395,000
Orders Received	$175.1	$129.0	$62.9	$62.4	$131.9
Average Sales Price of Units Ordered	$275	$276	$283	$291	$334
Ending Backlog	$149.2	$75.4	$56.6	$95.0	$163.8

Average Sales Price of Ending Unit Backlog	$331	$296	$332	$342	$331

Production

The Company reviews the estimated sell-through from the independent distributors to retailers, as well as inventory levels at the independent distributors and at the Company, semi-monthly to plan

19

Index

production levels. These reviews resulted in decreased total unit production of 27% for the three months ended March 31, 2018 from the comparable prior year period.

Summary Unit Data

Firearms unit data for the trailing five quarters are as follows (dollar amounts shown are net of Federal Exc