

STURM RUGER & CO INC  
Form 10-Q  
November 01, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended October 1, 2016

OR

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

06-0633559

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(State or other jurisdiction of incorporation or organization) (I.R.S. employer identification no.)

Lacey Place, Southport, Connecticut 06890  
(Address of principal executive offices) (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  No

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  No

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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The number of shares outstanding of the issuer's common stock as of October 31, 2016: Common Stock, \$1 par value -18,971,854.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

## STURM, RUGER &amp; COMPANY, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

*(Dollars in thousands)*

|   | October 1, 2016 | December 31, 2015 |
|---|-----------------|-------------------|
|   |                 | (Note)            |
| Assets                                    |                 |                   |
| Current Assets                            |                 |                   |
| Cash                                      | \$ 101,363      | \$ 69,225         |
| Trade receivables, net                    | 70,323          | 71,721            |
| Gross inventories                         | 89,858          | 81,278            |
| Less LIFO reserve                         | (43,836)        | (42,061)          |
| Less excess and obsolescence reserve      | (2,448)         | (2,118)           |
| Net inventories                           | 43,574          | 37,099            |
| Deferred income taxes                     | 9,085           | 8,219             |
| Prepaid expenses and other current assets | 6,773           | 3,008             |
| Total Current Assets                      | 231,118         | 189,272           |
| Property, plant and equipment             | 320,465         | 308,597           |
| Less allowances for depreciation          | (218,401)       | (204,777)         |
| Net property, plant and equipment         | 102,064         | 103,820           |
| Other assets                              | 27,670          | 22,791            |
| Total Assets                              | \$ 360,852      | \$ 315,883        |

Note:

The consolidated balance sheet at December 31, 2015 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.*

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STURM, RUGER &amp; COMPANY, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

*(Dollars in thousands, except per share data)*

|   | October<br>1, 2016 | December<br>31, 2015<br>(Note) |
|---|--------------------|--------------------------------|
| Liabilities and Stockholders' Equity                |                    |                                |
| Current Liabilities                                 |                    |                                |
| Trade accounts payable and accrued expenses         | \$53,432           | \$42,991                       |
| Product liability                                   | 1,455              | 642                            |
| Employee compensation and benefits                  | 25,897             | 28,298                         |
| Workers' compensation                               | 4,421              | 5,100                          |
| Income taxes payable                                | —                  | 4,962                          |
| Total Current Liabilities                           | 85,205             | 81,993                         |
| Product liability                                   | 95                 | 102                            |
| Deferred income taxes                               | 9,436              | 6,050                          |
| Contingent liabilities – Note 10                    | —                  | —                              |
| 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                      |                    |                                |
| 2016 – 24,034,201 issued,<br>18,971,854 outstanding | 24,034             | 23,776                         |
| 2015 – 23,775,766 issued,<br>18,713,419 outstanding |                    |                                |
| Additional paid-in capital                          | 26,371             | 29,591                         |
| Retained earnings                                   | 280,438            | 239,098                        |
| Less: Treasury stock – at cost                      |                    |                                |
| 2016 – 5,062,347 shares                             | (64,727 )          | (64,727 )                      |
| 2015 – 5,062,347 shares                             |                    |                                |
| Total Stockholders' Equity                          | 266,116            | 227,738                        |
| Total Liabilities and Stockholders' Equity          | \$360,852          | \$315,883                      |

Note:

The consolidated balance sheet at December 31, 2015 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.*

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STURM, RUGER &amp; COMPANY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(UNAUDITED)*(Dollars in thousands, except per share data)*

|                                     | Three Months Ended |            | Nine Months Ended |            |
|-------------------------------------|--------------------|------------|-------------------|------------|
|                                     | October            | September  | October           | September  |
|                                     | 1,                 | 26,        | 1,                | 26,        |
|                                     | 2016               | 2015       | 2016              | 2015       |
| Net firearms sales                  | \$ 160,058         | \$ 119,281 | \$ 497,889        | \$ 394,084 |
| Net castings sales                  | 1,369              | 1,590      | 4,591             | 4,614      |
| Total net sales                     | 161,427            | 120,871    | 502,480           | 398,698    |
| Cost of products sold               | 111,176            | 86,860     | 336,422           | 274,781    |
| Gross profit                        | 50,251             | 34,011     | 166,058           | 123,917    |
| Operating expenses:                 |                    |            |                   |            |
| Selling                             | 13,378             | 9,170      | 41,261            | 34,255     |
| General and administrative          | 6,805              | 6,880      | 22,045            | 21,214     |
| Total operating expenses            | 20,183             | 16,050     | 63,306            | 55,469     |
| Operating income                    | 30,068             | 17,961     | 102,752           | 68,448     |
| Other income:                       |                    |            |                   |            |
| Interest expense, net               | (32 )              | (36 )      | (102 )            | (113 )     |
| Other income, net                   | 418                | 247        | 917               | 1,333      |
| Total other income, net             | 386                | 211        | 815               | 1,220      |
| Income before income taxes          | 30,454             | 18,172     | 103,567           | 69,668     |
| Income taxes                        | 10,604             | 6,209      | 36,925            | 24,642     |
| Net income and comprehensive income | \$ 19,850          | \$ 11,963  | \$ 66,642         | \$ 45,026  |
| Basic earnings per share            | \$ 1.05            | \$ 0.64    | \$ 3.51           | \$ 2.41    |
| Diluted earnings per share          | \$ 1.03            | \$ 0.62    | \$ 3.48           | \$ 2.33    |
| Cash dividends per share            | \$ 0.49            | \$ 0.36    | \$ 1.32           | \$ 0.85    |

*See notes to condensed consolidated financial statements.*

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STURM, RUGER &amp; COMPANY, INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

*(Dollars in thousands)*

|   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Total      |
|---|-----------------|----------------------------------|----------------------|-------------------|------------|
| Balance at December 31, 2015                    | \$ 23,776       | \$ 29,591                        | \$ 239,098           | \$(64,727)        | \$ 227,738 |
| Net income and comprehensive income             |                 |                                  | 66,642               |                   | 66,642     |
| Dividends paid                                  |                 |                                  | (25,036 )            |                   | (25,036 )  |
| Unpaid dividends accrued                        |                 |                                  | (266 )               |                   | (266 )     |
| Recognition of stock-based compensation expense |                 | 2,213                            |                      |                   | 2,213      |
| Vesting of RSU's                                |                 | (14,001 )                        |                      |                   | (14,001 )  |
| Tax benefit realized from vesting of RSU's      |                 | 8,826                            |                      |                   | 8,826      |
| Common stock issued-compensation plans          | 258             | (258 )                           |                      |                   | —          |
| Balance at October 1, 2016                      | \$ 24,034       | \$ 26,371                        | \$ 280,438           | \$(64,727)        | \$ 266,116 |

*See notes to condensed consolidated financial statements.*

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STURM, RUGER &amp; COMPANY, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

*(Dollars in thousands)*

|   | Nine Months Ended |           |
|---|-------------------|-----------|
|   | October           | September |
|   | 1,                | 26,       |
|   | 2016              | 2015      |
| <b>Operating Activities</b>   |                   |           |
| Net income  | \$66,642          | \$45,026  |
| Adjustments to reconcile net income to cash provided by operating activities:   |                   |           |
| Depreciation and amortization   | 25,257            | 26,693    |
| Slow moving inventory valuation adjustment                                      | 630               | (1,126 )  |
| Stock-based compensation  | 2,213             | 3,442     |
| Loss (gain) on sale of assets   | 50                | (157 )    |
| Deferred income taxes   | 2,520             | (78 )     |
| Impairment of assets  | 6                 | 32        |
| Changes in operating assets and liabilities:                                    |                   |           |
| Trade receivables   | 1,398             | (3,247 )  |
| Inventories   | (7,105 )          | 5,054     |
| Trade accounts payable and accrued expenses                                     | 9,762             | 956       |
| Employee compensation and benefits  | (2,667 )          | 8,602     |
| Product liability   | 806               | (101 )    |
| Prepaid expenses, other assets and other liabilities                            | (5,340 )          | 5,652     |
| Income taxes payable and prepaid income taxes                                   | (8,781 )          | 4,201     |
| Cash provided by operating activities   | 85,391            | 94,949    |
| <b>Investing Activities</b>   |                   |           |
| Property, plant and equipment additions   | (23,049 )         | (24,488 ) |
| Proceeds from sale of assets  | 7                 | 222       |
| Cash used for investing activities  | (23,042 )         | (24,266 ) |
| <b>Financing Activities</b>   |                   |           |
| Tax benefit from exercise of stock options and vesting of RSU's                 | 8,826             | 305       |
| Remittance of taxes withheld from employees related to share-based compensation | (14,001 )         | (1,000 )  |
| Proceeds from exercise of stock options   | —                 | 97        |
| Repurchase of common stock  | —                 | (2,841 )  |
| Dividends paid  | (25,036 )         | (15,893 ) |
| Cash used for financing activities  | (30,211 )         | (19,332 ) |
| Increase in cash and cash equivalents   | 32,138            | 51,351    |

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|  |           |          |
|--|-----------|----------|
| Cash and cash equivalents at beginning of period | 69,225    | 8,901    |
| Cash and cash equivalents at end of period       | \$101,363 | \$60,252 |

*See notes to condensed consolidated financial statements.*

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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 nine months ended October 1, 2016 may not be indicative of the results to be expected for the full year ending December 31, 2016. 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, 2015.

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.

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.

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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:

On March 30, 2016, Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“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 is effective in fiscal years beginning after December 15, 2016 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 and whether to adopt the guidance early.

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 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 - 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.

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Inventories consist of the following:

|                                       | October 1, 2016 |   | December 31, 2015 |
|---------------------------------------|-----------------|---|-------------------|
| Inventory at FIFO                     |                 |   |                   |
| Finished products                     | \$ 19,123       |   | \$ 16,637         |
| Materials and work in process         | 70,735          |   | 64,641            |
| Gross inventories                     | 89,858          |   | 81,278            |
| Less: LIFO reserve                    | (43,836         | ) | (42,061           |
| Less: excess and obsolescence reserve | (2,448          | ) | (2,118            |
| Net inventories                       | \$ 43,574       |   | \$ 37,099         |

## NOTE 4 - LINE OF CREDIT

The Company has a \$40 million revolving line of credit with a bank. This facility is renewable annually and terminates on June 15, 2017. Borrowings under this facility bear interest at LIBOR (1.556% at October 1, 2016) plus 200 basis points. The Company is charged three-eighths of a percent (0.375%) per year on the unused portion. At October 1, 2016 and December 31, 2015, the Company was in compliance with the terms and covenants of the credit facility, which remains unused.

## NOTE 5 - 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 Internal Revenue Code. Expenses related to these matching contributions totaled \$0.8 million and \$2.5 million for the three and nine months ended October 1, 2016, respectively, and \$0.7 million and \$2.5 million for the three and nine months ended September 26, 2015, respectively. The Company plans to contribute approximately \$0.8 million to the plan in matching employee contributions during the remainder of 2016.

In addition, the Company provided supplemental discretionary contributions to the 401(k) plan totaling \$1.4 million and \$4.5 million for the three and nine months ended October 1, 2016, respectively, and \$1.3 million and \$3.7 million for the three and nine months ended September 26, 2015, respectively. The Company plans to contribute approximately \$1.4 million in supplemental contributions to the plan during the remainder of 2016.

NOTE 6 - INCOME TAXES

The Company's 2016 and 2015 effective tax rates differ from the statutory federal tax rate due principally to state income taxes partially offset by tax benefits related to the American Jobs Creation Act of 2004. The Company's effective income tax rate in the three and nine months ended October 1, 2016 was 34.8% and 35.7%, respectively. The Company's effective income tax rate in the three and nine months ended September 26, 2015 was 34.2% and 35.4%, respectively.

Income tax payments for the three and nine months ended October 1, 2016 totaled \$13.5 million and \$34.4 million, respectively. Income tax payments for the three and nine months ended September 26, 2015 totaled \$8.3 million \$20.6 million, respectively.

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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 2013.

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 7 - 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 |                          | Nine Months Ended  |                          |
|---|--------------------|--------------------------|--------------------|--------------------------|
|   | October 1,<br>2016 | September<br>26,<br>2015 | October 1,<br>2016 | September<br>26,<br>2015 |
| Numerator:  |                    |                          |                    |                          |
| Net income  | \$ 19,850          | \$ 11,963                | \$ 66,642          | \$ 45,026                |
| Denominator:  |                    |                          |                    |                          |
| Weighted average number of common shares outstanding –<br>Basic   | 18,971,854         | 18,701,530               | 18,961,146         | 18,692,755               |
| Dilutive effect of options and restricted stock units<br>outstanding under the Company’s employee compensation<br>plans | 232,321            | 673,013                  | 204,731            | 650,910                  |
| Weighted average number of common shares outstanding –<br>Diluted   | 19,204,175         | 19,374,543               | 19,165,877         | 19,343,665               |

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 8 - COMPENSATION PLANS

In April 2007, the Company adopted and the shareholders approved the 2007 Stock Incentive Plan (the “2007 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 2,550,000 shares for issuance under the 2007 SIP, of which 471,000 shares remain available for future grants as of October 1, 2016.

Compensation costs related to all share-based payments recognized in the statements of operations aggregated \$0.8 million and \$2.2 million for the three and nine months ended October 1, 2016, respectively, and \$1.1 million and \$3.4 million for the three and nine months ended September 26, 2015, respectively.

IndexStock Options

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

|                                  | Shares | Weighted<br>Average<br>Exercise<br>Price | Grant<br>Date<br>Fair<br>Value |
|----------------------------------|--------|--|--------------------------------|
| Outstanding at December 31, 2015 | 11,838 | \$ 8.95                                  | \$ 6.69                        |
| Granted                          | —      | —  | —                              |
| Exercised                        | —      | —  | —                              |
| Expired                          | —      | —  | —                              |
| Outstanding at October 1, 2016   | 11,838 | \$ 8.95                                  | \$ 6.69                        |

The aggregate intrinsic value (mean market price at October 1, 2016 less the weighted average exercise price) of options outstanding under the 2007 SIP was approximately \$0.6 million.

Restricted Stock Units

Beginning in 2009, the Company began granting restricted stock units to senior employees in lieu of incentive stock options. The vesting of these awards is dependent on the achievement of corporate objectives established by the Compensation Committee of the Board of Directors. Beginning in 2011, a three year vesting period was added to the performance criteria, which had the effect of requiring both the achievement of the corporate performance objectives and the satisfaction of the vesting period.

There were 72,148 restricted stock units issued during the nine months ended October 1, 2016. Total compensation costs related to these restricted stock units are \$4.0 million. These costs are being recognized ratably over vesting periods ranging from three to five years. Total compensation cost related to restricted stock units was \$0.8 million and \$2.2 million for the three and nine months ended October 1, 2016, respectively, and \$1.1 million and \$3.4 million for the three and nine months ended September 26, 2015, respectively.

## NOTE 9 - 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.

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Selected operating segment financial information follows:

| (in thousands)                    | Three Months Ended |                    | Nine Months Ended |                    |
|-----------------------------------|--------------------|--------------------|-------------------|--------------------|
|                                   | October 1, 2016    | September 26, 2015 | October 1, 2016   | September 26, 2015 |
| Net Sales                         |                    |                    |                   |                    |
| Firearms                          | \$ 160,058         | \$ 119,281         | \$ 497,889        | \$ 394,084         |
| Castings                          |                    |                    |                   |                    |
| Unaffiliated                      | 1,369              | 1,590              | 4,591             | 4,614              |
| Intersegment                      | 9,114              | 7,635              | 27,564            | 23,926             |
|                                   | 10,483             | 9,225              | 32,155            | 28,540             |
| Eliminations                      | (9,114 )           | (7,635 )           | (27,564 )         | (23,926 )          |
|                                   | \$ 161,427         | \$ 120,871         | \$ 502,480        | \$ 398,698         |
| Income (Loss) Before Income Taxes |                    |                    |                   |                    |
| Firearms                          | \$ 29,785          | \$ 19,719          | \$ 103,834        | \$ 71,073          |
| Castings                          | 144                | (1,897 )           | (949 )            | (2,906 )           |
| Corporate                         | 525                | 350                | 682               | 1,501              |
|                                   | \$ 30,454          | \$ 18,172          | \$ 103,567        | \$ 69,668          |

|                     | October 1, 2016 | December 31, 2015 |
|---------------------|-----------------|-------------------|
| Identifiable Assets |                 |                   |
| Firearms            | \$ 233,686      | \$ 221,670        |
| Castings            | 15,259          | 15,289            |
| Corporate           | 111,907         | 78,924            |
|                     | \$ 360,852      | \$ 315,883        |

## NOTE 10 - CONTINGENT LIABILITIES

As of October 1, 2016, the Company was a defendant in four (4) lawsuits and is aware of certain other such claims. The lawsuits fall into three categories: traditional product liability litigation, patent litigation and municipal litigation, discussed in turn below.

Traditional Product Liability Litigation

Two of the four lawsuits mentioned above involve claims for damages related to allegedly defective products due to their design and/or manufacture. The lawsuits stem from specific incidents of personal injury and are based on traditional product liability theories such as strict liability, negligence and/or breach of warranty.

The Company management believes the allegations in these cases are unfounded, that the incidents are unrelated to the design or manufacture of the firearms, and that there should be no recovery against the Company.

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Patent Litigation

*Davies Innovations, Inc. v. Sturm, Ruger & Company, Inc.* is a patent litigation suit originally filed in the United States District Court for the Southern District of Texas, Galveston Division. The case subsequently was transferred to the United States District Court for the Northern District of New Hampshire. The suit is based upon alleged patent infringement as the plaintiff claims that certain features of the Ruger SR-556 and SR-762 modern sporting rifles infringe its patent. The complaint seeks a judgment of infringement and unspecified monetary damages including costs, fees and treble damages.

The Company management believes the allegations in this case are unfounded, that there is no infringement of plaintiff's patent, that plaintiff's patent is invalid, and that there should be no recovery against the Company. The Company has filed a Motion for Summary Judgment in the action, which is scheduled to be heard on December 6, 2016.

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, over seventeen years ago. 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 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.

Last year, Indiana passed a new law, Indiana Code § 34-12-3-1, (the "Indiana Immunity Statute"), which applies to the City's case. The defendants have filed a joint motion for judgment on the pleadings, asserting immunity under the

Indiana Immunity Statute and asking the court to re-visit the Court of Appeals' earlier decision holding the Protection of Lawful Commerce in Arms Act ("PLCAA") inapplicable to the City's claims.

The United States and the Indiana Attorney General filed motions and briefs in intervention in defense of the constitutionality of the PLCAA and the Indiana Immunity Statute, respectively. A hearing on the motions to intervene was set for October 12, 2016.

The court subsequently granted a Joint Motion to Stay Resolution of Manufacturers' Motion for Judgment on the Pleadings for six months or until the *KS&E Sports v. Runnels* case is decided by the Indiana Supreme Court, whichever is earlier. The court also vacated the October 12<sup>th</sup> hearing on

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motions to intervene by the United States and the Indiana Attorney General, given the City's consent to such motions.

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. Aggregate claimed amounts presently 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 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 \$0.0 million at December 31, 2015 and 2014, respectively, are set forth as an indication of 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 11 - SUBSEQUENT EVENTS

On October 28, 2016, the Company's Board of Directors authorized a dividend of 41¢ per share, for shareholders of record as of November 18, 2016, payable on November 25, 2016.

The Company has evaluated events and transactions occurring subsequent to October 1, 2016 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.

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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 third-party 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 increased 19% in the first nine months of 2016 from the comparable prior year period. For the same period, the National Instant Criminal Background Check System ("NICS") background checks (as adjusted by the National Shooting Sports Foundation ("NSSF")) increased 16%. The increase in estimated sell-through of the Company's products from the independent distributors to retailers is attributable to:

stronger-than-normal seasonal industry demand, likely bolstered by the political campaigns for the elections in November,

strong demand for certain new products,  
greater availability of rimfire ammunition which spurred demand for our 10/22 rifle and other rimfire firearms late in the third quarter, and

increased production of several products in strong demand.

The Company launched new Mark IV pistols, the LCP II pistol, and compact models of the American pistol in September.

Sales of new products, including those launched in the third quarter as well as the Precision Rifle, the AR-556 modern sporting rifle, and the LC9s pistol, represented \$160.8 million or 32% of firearm sales in the first nine months of 2016. The new product sales percentage is expected to decrease next quarter as sales of the AR-556 and the LC9s will no longer be included among the new products. New product sales include only major new products that were introduced in the past two years.

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

|   | 2016    |         |         | 2015    |         |         |         |
|---|---------|---------|---------|---------|---------|---------|---------|
|   | Q3      | Q2      | Q1      | Q4      | Q3      | Q2      | Q1      |
| Estimated Units Sold from Distributors to Retailers (1) | 453,400 | 453,700 | 571,000 | 552,700 | 374,900 | 379,400 | 400,000 |
| Total adjusted NICS Background Checks (thousands) (2)   | 3,519   | 3,199   | 4,148   | 4,880   | 3,050   | 2,793   | 3,000   |

The estimates for each period were calculated by taking the beginning inventory at the distributors, plus shipments (1) 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.

NICS background checks are performed when the ownership of most firearms, either new or used, is transferred by (2) 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 average sales price of units in the third quarter of 2016 was reduced due to strong orders for the relatively lower priced LCP II pistol, and the cancellation of orders for the original version of relatively higher priced Precision modern sporting rifle, which was discontinued due to the popularity of the new Enhanced Precision rifle.

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

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

|  | 2016<br>Q3 | Q2      | Q1      | 2015<br>Q4 | Q3      | Q2      | Q1      |
|--|------------|---------|---------|------------|---------|---------|---------|
| Units Ordered                              | 445,700    | 399,400 | 969,400 | 696,400    | 207,500 | 262,400 | 350,700 |
| Orders Received                            | \$116.5    | \$145.7 | \$296.1 | \$203.4    | \$73.1  | \$71.9  | \$114.8 |
| Average Sales Price of Units Ordered       | \$261      | \$365   | \$305   | \$292      | \$352   | \$274   | \$327   |
| Ending Backlog                             | \$219.1    | \$257.6 | \$276.1 | \$137.8    | \$80.5  | \$123.8 | \$185.1 |
| Average Unit Sales Price of Ending Backlog | \$306      | \$331   | \$313   | \$320      | \$379   | \$310   | \$319   |

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 production levels. These reviews resulted in increased total unit production of 20% for both the three and nine months ended October 1, 2016 from the comparable prior year periods.

Summary Unit Data

Firearms unit data for the trailing seven quarters are as follows (dollar amounts shown are net of Federal Excise Tax of 10% for handguns and 11% for long guns):

|                                      | 2016<br>Q3 | Q2      | Q1      | 2015<br>Q4 | Q3      | Q2      | Q1      |
|--------------------------------------|------------|---------|---------|------------|---------|---------|---------|
| Units Ordered                        | 445,700    | 399,400 | 969,400 | 696,400    | 207,500 | 262,400 | 350,700 |
| Units Produced                       | 527,600    | 529,600 | 502,100 | 425,400    | 439,900 | 487,000 | 369,000 |
| Units Shipped                        | 507,500    | 504,000 | 516,700 | 478,400    | 394,700 | 442,900 | 422,100 |
| Average Sales Price of Units Shipped | \$315      | \$330   | \$332   | \$315      | \$302   | \$314   | \$321   |

|                  |         |         |         |         |         |         |         |
|------------------|---------|---------|---------|---------|---------|---------|---------|
| Units on Backlog | 716,600 | 778,400 | 883,000 | 430,300 | 212,300 | 399,500 | 580,000 |
|------------------|---------|---------|---------|---------|---------|---------|---------|

Inventories

During the third quarter of 2016, the Company's finished goods inventory increased by 20,000 units and distributor inventories of the Company's products increased by 54,100 units. Increases in inventory, which often occur in the second and third quarters, can be beneficial as they allow the Company to:

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Level load production, which results in more efficient manufacturing,  
 Reduce capacity needed to meet the demand during the strongest seasonal peaks, and  
 Capitalize on unanticipated peaks in demand.

Inventory data for the trailing seven quarters follows:

|                                   | 2016    |         |         | 2015    |         |         |         |
|-----------------------------------|---------|---------|---------|---------|---------|---------|---------|
|                                   | Q3      | Q2      | Q1      | Q4      | Q3      | Q2      | Q1      |
| Units – Company Inventory         | 118,500 | 98,500  | 72,800  | 87,400  | 140,400 | 95,200  | 51,100  |
| Units – Distributor Inventory (1) | 321,100 | 267,000 | 216,700 | 271,000 | 345,300 | 325,500 | 262,000 |
| Total inventory (2)               | 439,600 | 365,500 | 289,500 | 358,400 | 485,700 | 420,700 | 313,100 |

(1) Distributor ending inventory is provided by the Company’s independent distributors. These numbers do not include goods-in-transit inventory that has been shipped from the Company but not yet received by the distributors.

(2) This total does not include inventory at retailers. The Company does not have access to data on retailer inventories of the Company’s products.

Net Sales

Consolidated net sales were \$161.4 million for the three months ended October 1, 2016, an increase of 33.6% from \$120.9 million in the comparable prior year period.

For the nine months ended October 1, 2016, consolidated net sales were \$502.5 million, an increase of 26.0% from \$398.7 million in the comparable prior year period.

Firearms net sales were \$160.1 million for the three months ended October 1, 2016, an increase of 34.2% from \$119.3 million in the comparable prior year period.

For the nine months ended October 1, 2016, firearms net sales were \$497.9 million, an increase of 26.3% from \$394.1 million in the comparable prior year period.

Firearms unit shipments increased 28.6% and 21.3% for the three and nine months ended October 1, 2016, respectively, from the comparable prior year periods.

Casting net sales were \$1.4 million for the three months ended October 1, 2016, a decrease of 13.9% from \$1.6 million in the comparable prior year period.

For the nine months ended October 1, 2016, castings net sales were \$4.6 million, a decrease of 0.5% from \$4.6 million in the comparable prior year period.

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Cost of Products Sold and Gross Profit

Consolidated cost of products sold was \$111.2 million for the three months ended October 1, 2016, an increase of 28.0% from \$86.9 million in the comparable prior year period.

For the nine months ended October 1, 2016, consolidated cost of products sold was \$336.4 million, an increase of 22.4% from \$274.8 million in the comparable prior year period.

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Gross margin was 31.1% and 33.0% for the three and nine months ended October 1, 2016, respectively, compared to 28.1% and 31.1% in the comparable prior year periods as illustrated below (in thousands):

|  | Three Months Ended |         |                    |        |
|--|--------------------|---------|--------------------|--------|
|  | October 1, 2016    |         | September 26, 2015 |        |
| Net sales  | \$ 161,427         | 100.0%  | \$ 120,871         | 100.0% |
| Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory and product liability | 109,302            | 67.7 %  | 84,377             | 69.8 % |
| LIFO expense   | 576                | 0.4 %   | 694                | 0.6 %  |
| Overhead rate adjustments to inventory   | 748                | 0.5 %   | 1,149              | 0.9 %  |
| Labor rate adjustments to inventory  | (107 )             | (0.1 )% | 62                 | 0.1 %  |
| Product liability  | 657                | 0.4 %   | 578                | 0.5 %  |
| Total cost of products sold  | 111,176            | 68.9 %  | 86,860             | 71.9 % |
| Gross profit   | \$ 50,251          | 31.1 %  | \$ 34,011          | 28.1 % |

|  | Nine Months Ended |        |                    |        |
|--|-------------------|--------|--------------------|--------|
|  | October 1, 2016   |        | September 26, 2015 |        |
| Net sales  | \$ 502,480        | 100.0% | \$ 398,698         | 100.0% |
| Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory and product liability | 331,797           | 66.0 % | 269,107            | 67.5 % |
| LIFO expense   | 1,775             | 0.4 %  | 1,704              | 0.4 %  |
| Overhead rate adjustments to inventory   | 1,239             | 0.3 %  | 2,952              | 0.7 %  |
| Labor rate adjustments to inventory  | 116               | —      | 346                | 0.1 %  |
| Product liability  | 1,495             | 0.3 %  | 672                | 0.2 %  |
| Total cost of products sold  | 336,422           | 67.0 % | 274,781            | 68.9 % |

|              |           |        |           |        |
|--------------|-----------|--------|-----------|--------|
| Gross profit | \$166,058 | 33.0 % | \$123,917 | 31.1 % |
|--------------|-----------|--------|-----------|--------|

Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, and product liability — During the three months ended October 1, 2016, cost of products sold, before LIFO,

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overhead and labor rate adjustments to inventory, and product liability decreased as a percentage of sales by 2.1% compared with the comparable 2015 period primarily due to the increased sales volume and the leverage of fixed overhead costs.

For the nine months ended October 1, 2016, cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, and product liability decreased as a percentage of sales by 1.5% compared with the comparable 2015 period due principally to the increased sales volume and the leverage of fixed overhead costs.

LIFO — For the three months ended October 1, 2016, the Company recognized LIFO expense resulting in increased cost of products sold of \$0.6 million. In the comparable 2015 period, the Company recognized LIFO expense resulting in increased cost of products sold of \$0.7 million.

For the nine months ended October 1, 2016, the Company recognized LIFO expense resulting in increased cost of products sold of \$1.8 million. In the comparable 2015 period, the Company recognized LIFO expense resulting in increased cost of products sold of \$1.7 million.

Overhead Rate Adjustments — The Company uses actual overhead expenses incurred as a percentage of sales-value-of-production over a trailing six month period to absorb overhead expense into inventory. During the three and nine months ended October 1, 2016, the Company became more efficient in overhead spending and the overhead rates used to absorb overhead expenses into inventory decreased, resulting in decreases in inventory values of \$0.7 million and \$1.2 million, respectively, and corresponding increases to cost of products sold.

During the three and nine months ended September 26, 2015, the Company became more efficient in overhead spending and the overhead rates used to absorb overhead expenses into inventory decreased, resulting in a decrease in inventory value of \$1.2 million and \$3.0 million, respectively, and corresponding increases to cost of products sold.

Labor Rate Adjustments — The Company uses actual direct labor expense incurred as a percentage of sales-value-of-production over a trailing six month period to absorb direct labor expense into inventory. During the three months ended October 1, 2016, the Company became less efficient in direct labor utilization and the labor rates used to absorb incurred labor expenses into inventory increased, resulting in an increase in inventory value of \$0.1 million. This increase in inventory carry values resulted in a decrease to cost of products sold.

During the nine months ended October 1, 2016, the Company became more efficient in direct labor utilization and the labor rates used to absorb incurred labor expenses into inventory decreased, resulting in a decrease in inventory value of \$0.1 million. This decrease in inventory carrying values resulted in an increase to cost of products sold.

During the three and nine months ended September 26, 2015, the Company became more efficient in direct labor utilization and the labor rates used to absorb incurred labor expenses into inventory decreased, resulting in decreases in inventory value of \$0.1 million and \$0.3 million, respectively. These decreases in inventory carrying values resulted in increases to cost of products sold.

Product Liability — This expense includes the cost of outside legal fees, insurance, and other expenses incurred in the management and defense of product liability matters. During the three months ended October 1, 2016 product liability expense was \$0.7 million. During the nine months ended October 1, 2016 product liability expense was \$1.5 million.

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During the three and nine months ended September 26, 2015, product liability expense was \$0.6 million and \$0.7 million, respectively. See Note 10 to the notes to the condensed financial statements “Contingent Liabilities” for further discussion of the Company’s product liability.

Gross Profit — As a result of the foregoing factors, for the three and nine months ended October 1, 2016, gross profit was \$50.3 million and \$166.1 million, respectively, an increase of \$16.3 million and \$42.2 million from \$34.0 million and \$123.9 million in the comparable prior year periods.

Gross profit as a percentage of sales increased to 31.1% and 33.0% in the three and nine months ended October 1, 2016, respectively, from 28.1% and 31.1% in the comparable prior year periods.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$20.2 million for the three months ended October 1, 2016, an increase of \$4.1 million or 25.8% from the comparable prior year period. This increase is primarily attributable to the \$5.0 million expense related to the “NRA-ILA \$5 Million Matching Challenge”, which began in July 2016, and the increased sales volume.

Selling, general and administrative expenses were \$63.3 million for the nine months ended October 1, 2016, an increase of \$7.8 million or 14.1% from the comparable prior year period. This increase is attributable to the \$5.0 million expense related to the “NRA-ILA \$5 Million Matching Challenge”, which began in July 2016, and the \$1.6 million in additional expense related to the “2 Million Gun Challenge to Benefit the NRA”, which began in April 2015 and will run through October 2016, and the increased sales volume.

Other income, net

Other income, net was \$0.4 million and \$0.8 million in the three and nine months ended October 1, 2016, respectively, compared to \$0.2 million and \$1.2 million in the three and nine months ended September 26, 2015, respectively.

Income Taxes and Net Income

The Company's effective income tax rate in the three and nine months ended October 1, 2016 was 34.8% and 35.7%, respectively. The Company's effective income tax rate in the three and nine months ended September 26, 2015 was 34.2% and 35.4%, respectively.

As a result of the foregoing factors, consolidated net income was \$19.9 million and \$66.6 million for the three and nine months ended October 1, 2016, respectively. This represents an increase of 65.9% and 48.0% from \$12.0 million and \$45.0 million in the comparable prior year periods.

#### **Non-GAAP Financial Measure**

In an effort to provide investors with additional information regarding its financial results, the Company refers to various United States generally accepted accounting principles ("GAAP") financial measures and one non-GAAP financial measure, EBITDA, which management believes provides useful information to investors. This non-GAAP financial measure may not be comparable to similarly titled financial measures being disclosed by other companies. In addition, the Company believes that the non-

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GAAP financial measure should be considered in addition to, and not in lieu of, GAAP financial measures. The Company believes that EBITDA is useful to understanding its operating results and the ongoing performance of its underlying business, as EBITDA provides information on the Company's ability to meet its capital expenditure and working capital requirements, and is also an indicator of profitability. The Company believes that this reporting provides better transparency and comparability to its operating results. The Company uses both GAAP and non-GAAP financial measures to evaluate the Company's financial performance.

EBITDA is defined as earnings before interest, taxes, and depreciation and amortization. The Company calculates its EBITDA by adding the amount of interest expense, income tax expense, and depreciation and amortization expenses that have been deducted from net income back into net income, and subtracting the amount of interest income that was included in net income from net income.

EBITDA was \$39.1 million for the three months ended October 1, 2016, an increase of 44.3% from \$27.1 million in the comparable prior year period.

For the nine months ended October 1, 2016, EBITDA was \$128.9 million, an increase of 33.6% from \$96.5 million in the comparable prior year period.

## Non-GAAP Reconciliation – EBITDA

EBITDA

*(Unaudited, dollars in thousands)*

|                                       | Three Months Ended |                    | Nine Months Ended |                    |
|---------------------------------------|--------------------|--------------------|-------------------|--------------------|
|                                       | October 1, 2016    | September 26, 2015 | October 1, 2016   | September 26, 2015 |
| Net income                            | \$ 19,850          | \$ 11,963          | \$ 66,642         | \$ 45,026          |
| Income tax expense                    | 10,604             | 6,209              | 36,925            | 24,642             |
| Depreciation and amortization expense | 8,567              | 8,852              | 25,257            | 26,693             |
| Interest expense, net                 | 32                 | 36                 | 102               | 113                |
| EBITDA                                | \$ 39,053          | \$ 27,060          | \$ 128,926        | \$ 96,474          |

Financial Condition

Liquidity

At the end of the third quarter of 2016, the Company's cash totaled \$101.4 million. Pre-LIFO working capital of \$189.7 million, less the LIFO reserve of \$43.8 million, resulted in working capital of \$145.9 million and a current ratio of 2.7 to 1.

Operations

Cash provided by operating activities was \$85.4 million for the nine months ended October 1, 2016, compared to \$94.9 million for the comparable prior year period. This decrease is primarily due to an increase in inventories in the current period compared to a decrease in inventories in the prior year period and various other working capital fluctuations in both periods.

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Third parties supply the Company with various raw materials for its firearms and castings, such as fabricated steel components, walnut, birch, beech, maple and laminated lumber for rifle stocks, wax, ceramic material, metal alloys, various synthetic products and other component parts. There is a limited supply of these materials in the marketplace at any given time, which can cause the purchase prices to vary based upon numerous market factors. The Company believes that it has adequate quantities of raw materials in inventory or on order to provide sufficient time to locate and obtain additional items at then-current market cost without interruption of its manufacturing operations. However, if market conditions result in a significant prolonged inflation of certain prices or if adequate quantities of raw materials cannot be obtained, the Company's manufacturing processes could be interrupted and the Company's financial condition or results of operations could be materially adversely affected.

## Investing and Financing

Capital expenditures for the nine months ended October 1, 2016 totaled \$23.0 million, a decrease from \$24.5 million in the comparable prior year period. In 2016, the Company expects to spend approximately \$30 million on capital expenditures to purchase tooling fixtures and equipment for new product introductions and to upgrade and modernize manufacturing equipment. The Company finances, and intends to continue to finance, all of these activities with funds provided by operations and current cash.

Dividends of \$25.0 million were paid during the nine months ended October 1, 2016.

On October 28, 2016, the Board of Directors authorized a dividend of 41¢ per share, for shareholders of record as of November 18, 2016, payable on November 25, 2016. The payment of future dividends depends on many factors, including internal estimates of future performance, then-current cash and short-term investments, and the Company's need for funds. The Company has financed its dividends with cash provided by operations and current cash.

During the nine months ended September 26, 2015, the Company repurchased 82,100 shares of its common stock for \$2.8 million in the open market. The average price per share purchased was \$34.57. These purchases were funded with cash on hand. As of October 1, 2016, \$73.2 million remained authorized for future stock repurchases. No shares were repurchased in the nine months ended October 1, 2016.

Based on its unencumbered assets, the Company believes it has the ability to raise cash through the issuance of short-term or long-term debt. The Company's unsecured \$40 million credit facility, which expires on June 15, 2017, remained unused at October 1, 2016 and the Company has no debt.

## Other Operational Matters

In the normal course of its manufacturing operations, the Company is subject to occasional governmental proceedings and orders pertaining to workplace safety, firearms serial number tracking and control, waste disposal, air emissions and water discharges into the environment. The Company believes that it is generally in compliance with applicable Bureau of Alcohol, Tobacco, Firearms & Explosives, environmental, and safety regulations and the outcome of any proceedings or orders will not have a material adverse effect on the financial position or results of operations of the Company.

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The Company self-insures a significant amount of its product liability, workers' compensation, medical, and other insurance. It also carries significant deductible amounts on various insurance policies.

The Company expects to realize its deferred tax assets through tax deductions against future taxable income.

Adjustments to Critical Accounting Policies

The Company has not made any adjustments to its critical accounting estimates and assumptions described in the Company's 2015 Annual Report on Form 10-K filed on February 24, 2016, or the judgments affecting the application of those estimates and assumptions.

Forward-Looking Statements and Projections

The Company may, from time to time, make forward-looking statements and projections concerning future expectations. Such statements are based on current expectations and are subject to certain qualifying risks and uncertainties, such as market demand, sales levels of firearms, anticipated castings sales and earnings, the need for external financing for operations or capital expenditures, the results of pending litigation against the Company, the impact of future firearms control and environmental legislation, and accounting estimates, any one or more of which could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to publish revised forward-looking statements to reflect events or circumstances after the date such forward-looking statements are made or to reflect the occurrence of subsequent unanticipated events.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Historically, the Company has been exposed to changing interest rates on its investments, which consisted primarily of United States Treasury instruments with short-term (less than one year) maturities and cash. The interest rate market risk implicit in the Company's investments at any given time is typically low, as the investments mature within short periods and the Company does not have significant exposure to changing interest rates on invested cash, and there has been no material change in the Company's exposure to interest rate risks during the nine months ended October 1, 2016.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (the "Disclosure Controls and Procedures"), as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of October 1, 2016.

Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of October 1, 2016, such Disclosure Controls and Procedures are effective to

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ensure that information required to be disclosed in the Company's periodic reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer or persons performing similar functions, as appropriate, to allow timely decisions regarding disclosure.

Additionally, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, there have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended October 1, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The effectiveness of any system of internal controls and procedures is subject to certain limitations, and, as a result, there can be no assurance that the Disclosure Controls and Procedures will detect all errors or fraud. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system will be attained.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The nature of the legal proceedings against the Company is discussed at Note 10 to the financial statements, which are included in this Form 10-Q.

The Company has reported all cases instituted against it through July 2, 2016, and the results of those cases, where terminated, to the SEC on its previous Form 10-Q and 10-K reports, to which reference is hereby made.

During the three months ending October 1, 2016, one personal injury case was formally instituted against the Company, captioned *Shannon Wayne Garrison v. Sturm, Ruger & Company, Inc.*, which was filed on September 20, 2016 and is pending in the United States District Court for the Northern District of Alabama/Northeastern Division.

ITEM 1A. RISK FACTORS

There have been no material changes in the Company's risk factors from the information provided in Item 1A. Risk Factors included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. MINING SAFETY DISCLOSURES

Not applicable

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

(a)

Exhibits:

10.1 Transition Services and Consulting Agreement, dated as of August 1, 2016, by and between the Company and Michael O. Fifer. (1)

10.2 Agreement dated as of August 1, 2016, by and between the Company and Christopher J. Killoy. (1)

10.3 Letter agreement dated as of August 1, 2016, by and between the Company and Shawn C. Leska. (1)

31.1 Certification Pursuant to Rule 13a-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification Pursuant to Rule 13a-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to the Company's Form 8-K filed with the S.E.C. on August 2, 2016.

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STURM, RUGER & COMPANY, INC.

FORM 10-Q FOR THE THREE MONTHS ENDED OCTOBER 1, 2016

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

STURM, RUGER & COMPANY, INC.

Date: November 1, 2016 S/THOMAS A. DINEEN

Thomas A. Dineen

Principal Financial Officer,

Principal Accounting Officer,

Vice President, Treasurer and Chief Financial Officer

