

STURM RUGER & CO INC  
Form 10-Q  
July 28, 2010

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 July 3, 2010

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  
(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  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 "accelerated filer", "large 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

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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 July 23, 2010: Common Stock, \$1 par value  
-19,234,497.

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STURM, RUGER & COMPANY, INC.

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

STURM, RUGER & COMPANY, INC.

CONDENSED BALANCE SHEETS  
(Dollars in thousands, except share data)

|   | July 3,<br>2010 | December 31,<br>2009<br>(Note) |
|---|-----------------|--------------------------------|
| Assets                                    |                 |                                |
| Current Assets                            |                 |                                |
| Cash and cash equivalents                 | \$5,707         | \$5,008                        |
| Short-term investments                    | 52,982          | 50,741                         |
| Trade receivables, net                    | 22,383          | 25,049                         |
| Gross inventories                         | 49,438          | 51,048                         |
| Less LIFO reserve                         | (38,150 )       | (38,663 )                      |
| Less excess and obsolescence reserve      | (2,377 )        | (2,727 )                       |
| Net inventories                           | 8,911           | 9,658                          |
| Deferred income taxes                     | 4,536           | 5,893                          |
| Prepaid expenses and other current assets | 1,395           | 2,062                          |
| Total current assets                      | 95,914          | 98,411                         |
| Property, plant and equipment             | 145,377         | 134,057                        |
| Less allowances for depreciation          | (104,491 )      | (101,324 )                     |
| Net property, plant and equipment         | 40,886          | 32,733                         |
| Deferred income taxes                     | 5,627           | 6,190                          |
| Other assets                              | 3,702           | 4,345                          |
| Total Assets                              | \$146,129       | \$141,679                      |

Note:

The balance sheet at December 31, 2009 has been derived from the audited 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 financial statements.

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

CONDENSED BALANCE SHEETS (Continued)  
(Dollars in thousands, except share data)

|   | July 3,<br>2010 | December 31,<br>2009<br>(Note) |
|---|-----------------|--------------------------------|
| Liabilities and Stockholders' Equity                |                 |                                |
| Current Liabilities                                 |                 |                                |
| Trade accounts payable and accrued expenses         | \$9,018         | \$12,011                       |
| Product liability                                   | 424             | 1,147                          |
| Employee compensation and benefits                  | 8,556           | 12,890                         |
| Workers' compensation                               | 5,489           | 5,443                          |
| Income taxes payable                                | 384             | 1,543                          |
| Total current liabilities                           | 23,871          | 33,034                         |
| Accrued pension liability                           | 12,180          | 12,194                         |
| Product liability accrual                           | 762             | 935                            |
| Contingent liabilities – Note 9                     | --              | --                             |
| 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                      |                 |                                |
| 2010 – 22,988,318 issued,<br>19,234,497 outstanding |                 |                                |
| 2009 – 22,826,601 issued,<br>19,072,780 outstanding | 22,988          | 22,827                         |
| Additional paid-in capital                          | 8,109           | 8,031                          |
| Retained earnings                                   | 128,748         | 115,187                        |
| Less: Treasury stock – at cost                      |                 |                                |
| 2010 and 2009 – 3,753,821 shares                    | (30,167 )       | (30,167 )                      |
| Accumulated other comprehensive loss                | (20,362 )       | (20,362 )                      |
| Total Stockholders' Equity                          | 109,316         | 95,516                         |
| Total Liabilities and Stockholders' Equity          | \$146,129       | \$141,679                      |

## Note:

The balance sheet at December 31, 2009 has been derived from the audited 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 financial statements.



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

## CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share data)

|                                   | Three Months Ended |              | Six Months Ended |              |
|-----------------------------------|--------------------|--------------|------------------|--------------|
|                                   | July 3, 2010       | July 4, 2009 | July 3, 2010     | July 4, 2009 |
| Net firearms sales                | \$63,621           | \$71,372     | \$130,891        | \$133,600    |
| Net castings sales                | 768                | 1,018        | 1,775            | 2,320        |
| Total net sales                   | 64,389             | 72,390       | 132,666          | 135,920      |
| Cost of products sold             | 42,649             | 47,358       | 87,794           | 91,362       |
| Gross profit                      | 21,740             | 25,032       | 44,872           | 44,558       |
| Expenses:                         |                    |              |                  |              |
| Selling                           | 5,118              | 5,319        | 11,017           | 10,764       |
| General and administrative        | 3,984              | 5,563        | 7,919            | 9,709        |
| Other operating expenses, net     | -                  | 175          | 398              | 675          |
| Total operating expenses          | 9,102              | 11,057       | 19,334           | 21,148       |
| Operating income                  | 12,638             | 13,975       | 25,538           | 23,410       |
| Other income:                     |                    |              |                  |              |
| Interest (expense) income, net    | (24 )              | 39           | (57 )            | (40 )        |
| Other income (expense), net       | 174                | (14 )        | 301              | (4 )         |
| Total other income (expense), net | 150                | 25           | 244              | (44 )        |
| Income before income taxes        | 12,788             | 14,000       | 25,782           | 23,366       |
| Income taxes                      | 4,604              | 5,320        | 9,281            | 8,879        |
| Net income                        | \$8,184            | \$8,680      | \$16,501         | \$14,487     |
| Earnings per share                |                    |              |                  |              |
| Basic                             | \$0.43             | \$0.46       | \$0.86           | \$0.76       |
| Diluted                           | \$0.42             | \$0.45       | \$0.85           | \$0.76       |
| Average shares outstanding        |                    |              |                  |              |
| Basic                             | 19,196             | 19,059       | 19,141           | 19,052       |
| Diluted                           | 19,504             | 19,272       | 19,333           | 19,110       |
| Cash dividends per share          | \$0.093            | \$0.086      | \$0.153          | \$0.086      |

See notes to condensed financial statements.





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

## CONDENSED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

(Dollars in thousands)

|   | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Total     |
|---|-----------------|----------------------------------|----------------------|-------------------|---|-----------|
| Balance at December 31, 2009                  | \$22,827        | \$8,031                          | \$115,187            | \$(30,167 )       | \$(20,362 )                                   | \$95,516  |
| Net income and comprehensive<br>income        | -               | -                                | 16,501               | -                 | -   | 16,501    |
| Dividends paid                                | -               | -                                | (2,940 )             | -                 | -   | (2,940 )  |
| Stock-based compensation                      | -               | 908                              | -                    | -                 | -   | 908       |
| Cashless exercise of stock<br>options         | -               | (669 )                           | -                    | -                 | -   | (669 )    |
| Issuance of 161,717 shares of<br>common stock | 161             | (161 )                           | -                    | -                 | -   | -         |
| Balance at July 3, 2010                       | \$22,988        | \$8,109                          | \$128,748            | \$(30,167 )       | \$(20,362 )                                   | \$109,316 |

See notes to condensed financial statements.

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

## CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

|   | Six Months Ended |              |
|---|------------------|--------------|
|   | July 3, 2010     | July 4, 2009 |
| <b>Operating Activities</b>   |                  |              |
| Net income  | \$16,501         | \$14,487     |
| Adjustments to reconcile net income to cash provided by operating activities: |                  |              |
| Depreciation  | 4,419            | 3,325        |
| Slow moving inventory valuation adjustment                                    | (314 )           | (302 )       |
| Stock-based compensation  | 908              | 2,950        |
| Loss on sale of assets  | 10               | -            |
| Deferred income taxes   | 553              | (380 )       |
| Changes in operating assets and liabilities:                                  |                  |              |
| Trade receivables   | 2,666            | (1,725 )     |
| Inventories   | 1,061            | 6,176        |
| Trade accounts payable and accrued expenses                                   | (2,946 )         | (797 )       |
| Employee compensation   | (4,334 )         | 2,269        |
| Product liability   | (896 )           | (68 )        |
| Prepaid expenses, other assets and other liabilities                          | 1,296            | (769 )       |
| Income taxes payable  | (1,160 )         | (1,715 )     |
| Cash provided by operating activities   | 17,764           | 23,451       |
| <b>Investing Activities</b>   |                  |              |
| Property, plant and equipment additions                                       | (12,598 )        | (6,829 )     |
| Proceeds from sale of assets  | 16               | -            |
| Purchases of short-term investments   | (76,977 )        | (48,708 )    |
| Proceeds from maturities of short-term investments                            | 74,736           | 27,564       |
| Cash used for investing activities  | (14,823 )        | (27,973 )    |
| <b>Financing Activities</b>   |                  |              |
| Tax benefit from exercise of stock options                                    | 698              | 1,378        |
| Repayment of line of credit balance   | -                | (1,000 )     |
| Repurchase of common stock  | -                | (14 )        |
| Dividends paid  | (2,940 )         | (1,640 )     |
| Cash used for financing activities  | (2,242 )         | (1,276 )     |
| Increase (decrease) in cash and cash equivalents                              | 699              | (5,798 )     |
| Cash and cash equivalents at beginning of period                              | 5,008            | 9,688        |
| Cash and cash equivalents at end of period                                    | \$5,707          | \$3,890      |

See notes to condensed financial statements.



STURM, RUGER & COMPANY, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed 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 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 six months ended July 3, 2010 are not indicative of the results to be expected for the full year ending December 31, 2010. 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, 2009.

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 the Company's total sales for the three and six months ended July 3, 2010 were firearms sales, and approximately 1% were investment castings sales. Export sales represent approximately 6% 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 manufactures investment castings made from steel alloys for internal use in its firearms and utilizes available investment casting capacity to manufacture and sell castings to unaffiliated, third-party customers.

Fair Value of Financial Instruments:

The carrying amounts of financial instruments, including cash, short-term investments, 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 with current year presentation.



## NOTE 3 – SHORT-TERM INVESTMENTS

Short-term investments consist principally of United States Treasury instruments, all maturing within one year, and are recorded at cost plus accrued interest, which approximates market. The income from short-term investments is included in other income, net. The Company intends to hold these investments until maturity.

The Company evaluates securities for other than temporary impairment at least on a quarterly basis, and more frequently when market conditions warrant such evaluation. The Company has determined that the carrying value of short-term investments has not been impaired.

## 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 six month period ended July 3, 2010, 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 continues to occur in 2010, 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 (in thousands):

|                                       | July 3,<br>2010 | December 31,<br>2009 |
|---------------------------------------|-----------------|----------------------|
| Inventory at FIFO                     |                 |                      |
| Finished products                     | \$ 6,169        | \$ 4,623             |
| Materials and work in process         | 43,269          | 46,425               |
| Gross inventories                     | 49,438          | 51,048               |
| Less: LIFO reserve                    | (38,150 )       | (38,663 )            |
| Less: excess and obsolescence reserve | (2,377 )        | (2,727 )             |
| Net inventories                       | \$ 8,911        | \$ 9,658             |

## NOTE 5 - INCOME TAXES

The Company's 2010 and 2009 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 effective income tax rates for the three and six months ended July 3, 2010 and July 4, 2009 are 36.0% and 38.0%, respectively. Income tax payments in the three and six months ended July 3, 2010 totaled \$7.2 million and \$7.8 million, respectively. Income tax payments in the three and six months ended July 4, 2009 totaled \$7.0 million and \$10.9 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 2005. In the first quarter of 2009, the IRS completed audits of the Company's 2006 and 2007 federal income tax returns. Adjustments resulting from this examination did not result in a material change to the Company's financial position or results of operations.

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. However, the Company anticipates that it is more likely than not that additional state tax liabilities in the range of \$0.4 million to \$0.7 million exist. The Company has recorded \$0.7 million relating to these additional state income taxes, including approximately \$0.2 million for the payment of interest and penalties. This amount is included in income taxes payable at July 3, 2010. The Company will include any future interest and penalties related to uncertain tax positions as a component of its provision for taxes.

#### NOTE 6 - PENSION PLANS

The Company has migrated its retirement benefit focus from defined benefit pension plans to defined contribution retirement plans, utilizing its current 401(k) plan.

In 2007, the Company amended its hourly and salaried defined benefit pension plans so that employees will no longer accrue benefits under them effective December 31, 2007. This action "froze" the benefits for all employees and prevented future hires from joining the plans, effective December 31, 2007. Currently, the Company provides supplemental discretionary contributions to substantially all employees' individual 401(k) accounts.

In future years, the Company may be required to make cash contributions to the two defined benefit pension plans. The annual contributions will be based on the amount of the unfunded plan liabilities derived from the frozen benefits and will not include liabilities for any future accrued benefits for any new or existing participants. The total amount of these future cash contributions will depend on the investment returns generated by the plans' assets and the then applicable discount rates used to calculate the plans' liabilities.

Minimum cash contributions of \$1.7 million are required for the defined benefit plans for 2010. The Company voluntarily contributed \$2 million to the defined benefit plans in 2009 and plans on contributing approximately \$2 million in 2010. Contributions in the three and six months ended July 3, 2010 totaled \$0.5 million and \$1.0 million, respectively.

The estimated cost of the frozen defined benefit plans for 2010 is \$0.4 million.

Costs attributable to the supplemental discretionary 401(k) plan totaled \$0.5 million and \$0.9 million for the three and six months ended July 3, 2010, respectively, and \$0.5 million and \$0.9 million for the three and six months ended July 4, 2009, respectively. The Company plans to contribute approximately \$1.0 million to the plan during the remainder of 2010.

## NOTE 7 – SHARE BASED PAYMENTS

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 will be determined by the Compensation Committee or the Board of Directors. The Company has reserved 2,550,000 shares for issuance under the 2007 SIP of which 1,671,858 remain available for future grants as of July 3, 2010.

Compensation costs related to all share-based payments recognized in the statements of operations aggregated \$0.3 million and \$2.1 million for three months ended July 3, 2010 and July 4, 2009, respectively, and \$0.9 million and \$3.1 million for six months ended July 3, 2010 and July 4, 2009, respectively.

## Stock Options

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

|                                  | Shares     | Weighted Average<br>Exercise Price | Grant Date<br>Fair Value |
|----------------------------------|------------|------------------------------------|--------------------------|
| Outstanding at December 31, 2009 | 1,498,150  | \$ 9.00                            | \$ 4.13                  |
| Granted                          | 40,000     | \$ 9.70                            | \$ 4.80                  |
| Exercised                        | (325,750 ) | \$ 7.89                            | \$ 3.36                  |
| Expired                          | -          | -                                  | -                        |
| Outstanding July 3, 2010         | 1,212,400  | \$ 9.32                            | \$ 4.36                  |

The aggregate intrinsic value (mean market price at July 3, 2010 less the weighted average exercise price) of options outstanding under the plans was approximately \$6.5 million.

## Restricted Stock Units

Beginning in the second quarter of 2009, the Company began granting restricted stock units to senior employees, in lieu of incentive stock options. These awards vest dependent on the achievement of various corporate objectives established by the Compensation Committee of the Board of Directors.

Restricted stock units issued during the first and second quarters of 2010 were 21,900 and 17,100, respectively. Compensation costs related to these restricted stock units were \$0.3 million and \$0.3 million, respectively, which is being recognized over 72 months, the period available for the Company to achieve the required performance objectives. Compensation cost may be accelerated if the performance criteria is achieved sooner.

Beginning in 2008, a portion of all officers’ annual incentive compensation was paid in restricted stock units. During the first quarters of 2010 and 2009, awards totaling \$0.4 million and \$0.2 million, respectively, were made under this policy.

## NOTE 8 - BASIC AND DILUTED EARNINGS PER SHARE

Weighted average shares outstanding for the three and six months ended July 3, 2010 were 19,195,572 and 19,140,593, respectively. Weighted average shares outstanding for the three and six months ended July 4, 2009 were 19,058,537 and 19,051,775, respectively.



Diluted earnings per share reflect the impact of options outstanding using the treasury stock method, when applicable. This resulted in diluted weighted-average shares outstanding for the three and six months ended July 3, 2010, of 19,503,620 and 19,333,059, respectively. Diluted weighted-average shares outstanding for the three and six months ended July 4, 2009 were 19,272,412 and 19,109,862, respectively.

The following average numbers of stock options are anti-dilutive and therefore are not included in the diluted earnings per share calculation:

| Three Months Ended |              | Six Months Ended |              |
|--------------------|--------------|------------------|--------------|
| July 3,<br>2010    | July 4, 2009 | July 3,<br>2010  | July 4, 2009 |
| -                  | 256,250      | -                | 256,250      |

#### NOTE 9 - CONTINGENT LIABILITIES

As of July 3, 2010, the Company was a defendant in approximately three (3) lawsuits and is aware of certain other such claims.

Lawsuits involving the Company's products generally fall into one of two categories:

- (i) Those that claim damages from the Company related to allegedly defective product design and/or manufacture which stem from a specific incident. Pending lawsuits and claims are based principally on the theory of "strict liability" but also may be based on negligence, breach of warranty, and other legal theories; or
- (ii) Those brought by cities or other governmental entities, and individuals against firearms manufacturers, distributors and retailers seeking to recover damages allegedly arising out of the misuse of firearms by third-parties in the commission of homicides, suicides and other shootings involving juveniles and adults.

As to lawsuits of the first type, management believes that, in every case involving firearms, the allegations are unfounded, and that the shootings and any results therefrom were due to negligence or misuse of the firearms by third-parties or the claimant, and that there should be no recovery against the Company.

The only remaining lawsuit of the second type is the lawsuit filed by the City of Gary. 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. Market share allegations have been held inapplicable by the Indiana Supreme Court.

The Indiana Court of Appeals affirmed the dismissal of the Gary case by the trial court, but the Indiana Supreme Court reversed this dismissal and remanded the case for discovery proceedings on December 23, 2003. On November 23, 2005, the defendants filed a motion to dismiss pursuant to the PLCAA. The state court judge held the PLCAA unconstitutional and the defendants filed a motion with the Indiana Court of Appeals asking it to accept interlocutory appeal on the issue, which appeal was accepted on February 5, 2007. On October 29, 2007, the Indiana Appellate

Court affirmed, holding that the PLCAA does not apply to the City's claims. A petition for rehearing was filed in the Appellate Court and denied on January 9, 2008. On February 8, 2008, a Petition to Transfer the appeal to the Supreme Court of Indiana was filed. The petition was denied on January 13, 2009 and the case was remanded to the trial court. No trial date has been set.

In addition to the foregoing, on August 18, 2009, the Company was served with a complaint captioned Steamfitters Local 449 Pension Fund, on Behalf of Itself and All Others Similarly Situated v. Sturm, Ruger & Co. Inc., et al. pending in the United States District Court for the District of Connecticut. The complaint seeks unspecified damages for alleged violations of the Securities Exchange Act of 1934 and is a purported class action on behalf of purchasers of the Company's common stock between April 23, 2007 and October 29, 2007. On October 9, 2009, the Company waived service of a complaint captioned Alan R. Herrett, Individually and On Behalf of All Others Similarly Situated v. Sturm, Ruger & Co. Inc., et al. pending in the United States District Court for the District of Connecticut. This matter is based upon the same facts and basic allegations set forth in the Steamfitters Local 449 Pension Fund litigation. On October 12, 2009, a motion to consolidate the two actions was filed by counsel for the Steamfitters. On January 11, 2010, the court entered an order consolidating the two matters. A consolidated amended complaint was filed on March 11, 2010. The defendants, including the Company, filed a motion to dismiss on April 26, 2010 and plaintiffs filed a response on June 18, 2010. Defendants then filed a reply in support of the motion on July 19, 2010. Oral argument is scheduled for November 3, 2010.

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 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 reasonably possible that any single claim currently pending against the Company will have a material adverse effect on the financial position, results of operation, or cash flows of the Company.

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 our 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 our 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 loss 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 \$7.7 million and \$12.2 million at December 31, 2009 and 2008, respectively, are set forth as an indication of possible maximum liability that 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 10 - OPERATING SEGMENT INFORMATION

The Company has two reportable segments: firearms and investment castings. The firearms segment manufactures and sells rifles, pistols, revolvers, and shotguns principally to a select number of independent wholesale distributors primarily located in the United States. Two of these independent wholesale distributors merged in 2009. Further consolidation of independent wholesale distributors would result in a greater concentration of credit risk. The investment castings segment manufactures and sells steel investment castings. Selected operating segment financial information follows (in thousands):

|  | Three Months Ended |                 | Six Months Ended |                      |
|--|--------------------|-----------------|------------------|----------------------|
|  | July 3,<br>2010    | July 4,<br>2009 | July 3,<br>2010  | July 4,<br>2009      |
| <b>Net Sales</b>                         |                    |                 |                  |                      |
| Firearms                                 | \$63,621           | \$71,372        | \$130,891        | \$133,600            |
| Castings                                 |                    |                 |                  |                      |
| Unaffiliated                             | 768                | 1,018           | 1,775            | 2,320                |
| Intersegment                             | 3,670              | 4,876           | 7,115            | 9,039                |
|  | 4,438              | 5,894           | 8,890            | 11,359               |
| Eliminations                             | (3,670 )           | (4,876 )        | (7,115 )         | (9,039 )             |
|  | \$64,389           | \$72,390        | \$132,666        | \$135,920            |
| <b>Income (Loss) Before Income Taxes</b> |                    |                 |                  |                      |
| Firearms                                 | \$12,690           | \$14,413        | \$25,912         | \$24,025             |
| Castings                                 | (73 )              | (121 )          | (351 )           | (625 )               |
| Corporate                                | 171                | (292 )          | 221              | (34 )                |
|  | \$12,788           | \$14,000        | \$25,782         | \$23,366             |
|  |                    |                 | July 3,<br>2010  | December 31,<br>2009 |
| <b>Identifiable Assets</b>               |                    |                 |                  |                      |
| Firearms                                 |                    |                 | \$69,674         | \$66,011             |
| Castings                                 |                    |                 | 4,238            | 4,643                |
| Corporate                                |                    |                 | 72,217           | 71,025               |
|  |                    |                 | \$146,129        | \$141,679            |

## NOTE 11 – STOCK REPURCHASE

In 2009, the Company repurchased 2,400 shares of its common stock, representing 0.1% of the then outstanding shares, in the open market at an average price of \$6.03 per share. These purchases were made with cash held by the Company and no debt was incurred.

At December 31, 2009, \$4.7 million remained authorized for share repurchases. In February 2010, the Company announced that the Board of Directors expanded this repurchase program from \$4.7 million to \$10 million. To date, no share repurchases have been made since the \$10 million repurchase program was authorized.

## NOTE 12 – LINE OF CREDIT



In December 2009, the Company renewed a \$25 million credit facility with a bank. This facility is renewable annually and now terminates on December 12, 2010. Borrowings under this facility bear interest at LIBOR (1.19% at July 3, 2010) plus 200 basis points. The Company is charged 50 basis points per year on the unused portion. At July 3, 2010 and December 31, 2009, the Company was in compliance with the terms and covenants of the credit facility, which remains unused.

## NOTE 13 – SUBSEQUENT EVENTS

On July 27, 2010, the Company declared a dividend of 10.0¢ per share to shareholders of record on August 13, 2010.

The Company has evaluated events and transactions occurring subsequent to July 3, 2010 and determined that there were no other such events or transactions that would have a material impact on the Company's results of operations or financial position.

## 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 the Company's total sales for the three and six months ended July 3, 2010 were firearms sales, and approximately 1% were investment castings sales. Export sales represent approximately 6% 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 manufactures investment castings made from steel alloys for internal use in its firearms and utilizes excess investment casting capacity to manufacture and sell castings to unaffiliated, third-party customers.

Because most of the Company's competitors are not subject to public filing requirements and industry-wide data is generally not available in a timely manner, the Company is unable to compare its performance to other companies or specific current industry trends. Instead, the Company measures itself against its own historical results.

The Company does not consider its overall firearms business to be predictably seasonal; however, sales of mature products are usually lower in the second half of the year.

### Results of Operations

#### Product Demand

Estimated sell-through of the Company's products from distributors to retailers in the second quarter of 2010 decreased by approximately 6% from the second quarter of 2009 and approximately 16% from the first quarter of 2010. This decrease in estimated sell-through from distributors to retailers is likely due to the following factors:

- The completion of successful sales promotions that were in effect during the latter months of 2009 and the first quarter of 2010,
- The 11% reduction in NICS background checks from the first quarter of 2010, indicating a slowdown in overall firearms retail activity, and
- Normal, seasonal build-up of retailer inventories resulting from orders placed at annual distributor shows in the first quarter of 2010.

The estimated sell-through of the Company's products from distributors to retailers in the first half of 2010 increased 1% from the first half of 2009, despite a reduction in NICS checks of 2% during this period.



As previously reported, our estimated distributor sell-through in the first quarter of 2010 likely was higher than consumer demand due to the typical seasonal build-up of retailer inventories resulting from the annual distributor shows and sales promotions in the first quarter of 2010. Similarly, our estimated distributor sell-through in the second quarter of 2010 likely is less than consumer demand, an expected retracement, again due to the annual distributor shows and sales promotions in the first quarter of 2010. However, we still believe our sell-through estimate is probably a reasonable year-over-year comparative metric and an indicator of trends in consumer demand.

Estimated sell-through from distributors and total NICS checks for the trailing six quarters follows:

|  | 2010<br>Q2 | Q1      | 2009<br>Q4 | Q3      | Q2      | Q1      |
|--|------------|---------|------------|---------|---------|---------|
| Estimated Units Sold from<br>Distributors to Retailers (1) | 213,400    | 254,200 | 209,400    | 214,500 | 227,500 | 236,000 |
| Total NICS Background<br>Checks (millions) (2)             | 3,257      | 3,663   | 3,864      | 3,134   | 3,217   | 3,818   |

Note The estimates for each period were calculated by taking the beginning inventory at the distributors, plus 1: shipments from the Company to distributors during the period, less the ending inventory at distributors. These estimates are only a proxy for trends in consumer 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.

Note While NICS background checks are not an actual measure of retail activity, the trends in NICS background 2: checks are commonly used as a proxy for trends in consumer demand. NICS background checks are performed when the ownership of most firearms, either new or used, is transferred. NICS background checks are also performed for permit applications, permit renewals, and other administrative reasons.

New product introductions remain a strong driver of demand and represented \$41.9 million or 32% of sales in the first six months of 2010.

## Orders Received and Ending Backlog

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

|   | 2010<br>Q2 | Q1     | 2009<br>Q4 | Q3     | Q2      | Q1      |
|---|------------|--------|------------|--------|---------|---------|
| Orders Received (3) (5)                               | \$38.7     | \$81.8 | \$42.9     | \$14.1 | \$73.6  | \$138.9 |
| Average Sales Price of<br>Orders Received (3) (4) (5) | \$279      | \$270  | \$275      | \$196  | \$400   | \$308   |
| Ending Backlog (5)                                    | \$44.9     | \$71.8 | \$59.6     | \$78.0 | \$138.0 | \$136.3 |
| Average Sales Price of<br>Ending Backlog (5)          | \$304      | \$299  | \$330      | \$324  | \$335   | \$297   |

Note During the third quarter of 2009, the Company unilaterally cancelled all of the unshipped orders for Mini-14 and 3: Mini-Thirty auto-loading rifles, and asked the distributors to submit new orders that better represented their forecasted needs. The cancellation of these unshipped orders, partially offset by the submission of new orders for these products, resulted in a net reduction to the backlog of approximately \$20 million and decreased the Average Sales Price of Orders Received by \$115 per unit. Had these orders not been cancelled, the Average Sales Price of Orders Received would have been \$311 per unit. The Average Sales Price of the Ending Backlog was also impacted for the same reasons.

Note The average sales price of orders received in the third quarter of 2009 was lower than usual due to the net 4: cancellation of Mini-14 and Mini-Thirty rifles in that quarter, as discussed in Note 3 above. In the second quarter of 2009, the average sales price of orders received was higher than usual due to the initial stocking orders received for the SR-556 modern sporting rifle, which has a higher price relative to the other product lines.

Note 5: All amounts shown are net of Federal Excise Tax of 10% for handguns and 11% for long guns.

The incoming order rate in the second quarter of 2010 declined significantly from the first quarter of 2010 and the second quarter of 2009. This was due in part to the following:

- The completion of successful sales promotions during the first quarter of 2010 which generated large orders,
  - Stronger inventories throughout the distribution channel, and
- Continued reduction in the industry-wide surge in consumer demand that began in the fourth quarter of 2008.

## Production

Total unit production in the second quarter of 2010 decreased 1% from the first quarter of 2010, and 3% from the second quarter of 2009. Production of certain products in the second quarter of 2010 was limited to rates moderately in excess of estimated retail demand for those products, to allow for increased finished goods inventory levels for those products. The Company anticipates continuing to limit production of certain products in the third quarter of 2010 to avoid rebuilding finished goods inventory levels throughout the distribution channel too quickly.



The Company is continuing its implementation of lean manufacturing, a process that started in 2006. The current efforts in improving manufacturing processes are directed at combining smaller, single-piece flow cells that are dedicated to a product line into “super cells” that act as a focused factory for that product line. This should allow for further reduction of work-in-process inventories and improve efficiencies.

#### Summary Unit Data

Firearms unit data for the trailing six quarters are as follows:

|   | 2010<br>Q2 | 2010<br>Q1 | 2009<br>Q4 | Q3      | Q2      | Q1      |
|---|------------|------------|------------|---------|---------|---------|
| Estimated Units Sold from Distributors to Retailers | 213,400    | 254,200    | 209,400    | 214,500 | 227,500 | 236,000 |
| Units Ordered (6)                                   | 138,400    | 305,900    | 173,000    | 80,000  | 204,700 | 501,000 |
| Units Produced                                      | 238,900    | 241,900    | 234,600    | 242,500 | 247,300 | 209,900 |
| Units Shipped                                       | 225,500    | 237,300    | 228,500    | 237,400 | 246,200 | 213,700 |
| Average Sales Price                                 | \$276      | \$279      | \$276      | \$295   | \$286   | \$283   |
| Units on Backorder (6)                              | 147,900    | 239,900    | 181,000    | 240,700 | 412,300 | 458,900 |

Note See description in Note 3 above for information relating to order cancellations in the third quarter of 2009. The 6: cancellation of these orders reduced Units Ordered in the third quarter of 2009 by 34,000 units. Had these orders not been cancelled, the Units Ordered in the third quarter would have been approximately 114,000 units.

#### Inventories

The Company’s finished goods inventory increased 13,300 units during the second quarter of 2010, but remains below desired levels necessary to support rapid order fulfillment. The Company anticipates that finished goods inventory could increase by as much as \$7 million to \$10 million from the current level upon the attainment of the desired levels of finished goods inventory. The Company plans to build inventories up to desired levels gradually to mitigate potential future disruption of its manufacturing workforce. In the case of a significant market slowdown, the Company will likely build inventories up to desired levels at a faster pace.

Distributor inventories of the Company’s products increased 12,100 units during the second quarter of 2010, but, in the Company’s opinion, are still below the optimal level to support rapid fulfillment of retailer demand. As distributors continually attempt to increase their inventory turns without unduly hindering their ability to fulfill retail demand, distributor inventories of the Company’s products may increase at a slower rate than desired, or not at all. Distributor investments in other manufacturers’ products – some of which may not be turning as fast as the Company’s products turn, may further impede this inventory replenishment.

Inventory data for the trailing six quarters follows:

|                                   | 2010<br>Q2 | 2010<br>Q1 | 2009<br>Q4 | Q3     | Q2     | Q1     |
|-----------------------------------|------------|------------|------------|--------|--------|--------|
| Units – Company Inventory         | 37,700     | 24,400     | 20,100     | 15,100 | 9,600  | 8,800  |
| Units – Distributor Inventory (7) | 91,200     | 79,100     | 96,000     | 76,800 | 53,900 | 35,200 |
| Total inventory (8)               | 128,900    | 103,500    | 116,100    | 91,900 | 63,500 | 44,000 |

Note Distributor ending inventory as 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.

Note 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 \$64.4 million for the three months ended July 3, 2010. This represents a decrease of \$8.0 million or 11.1% from consolidated net sales of \$72.4 million in the comparable prior year period.

For the six months ended July 3, 2010, consolidated net sales were \$132.7 million, a decrease of \$3.2 million or 2.4% from sales of \$135.9 million in the comparable 2009 period.

Firearms net sales were \$63.6 million for the three months ended July 3, 2010. This represents a decrease of \$7.8 million or 10.9% from firearms net sales of \$71.4 million in the comparable prior year period.

For the six months ended July 3, 2010, firearms net sales were \$130.9 million. This represents a decrease of \$2.7 million or 2.0% from firearms net sales of \$133.6 million in the comparable 2009 period.

Firearms unit shipments decreased 8.4% for the three months ended July 3, 2010, but increased 0.6% for the six months ended July 3, 2010 from the comparable prior year periods.

Casting net sales were \$0.8 million for the three months ended July 3, 2010. This represents a decrease of \$0.2 million or 24.6% from casting sales of \$1.0 million in the comparable prior year period.

For the six months ended July 3, 2010, casting net sales were \$1.8 million. This represents a decrease of \$0.5 million or 23.5% from casting sales of \$2.3 million in the comparable prior year period.

#### Cost of Products Sold and Gross Margin

Consolidated cost of products sold was \$42.6 million for the three months ended July 3, 2010. This represents a decrease of \$4.8 million or 9.9% from consolidated cost of products sold of \$47.4 million in the comparable prior year period.

For the six months ended July 3, 2010, consolidated cost of products sold was \$87.8 million. This represents a decrease of \$3.6 million or 3.9% from consolidated cost of products sold of \$91.4 million in the comparable prior year



period.

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Gross margin as a percent of sales was 33.8% for the three and six months ended July 3, 2010. This represents a decrease from the gross margin percentage of 34.6% in the three months ended July 4, 2009 and an increase from 32.8% in the six months ended July 4, 2009 as illustrated below (in thousands):

|   | Three Months Ended |        |   |              |        |   |
|---|--------------------|--------|---|--------------|--------|---|
|   | July 3, 2010       |        |   | July 4, 2009 |        |   |
| Net sales   | \$64,389           | 100.0  | % | \$72,390     | 100.0  | % |
| Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall | 43,194             | 67.1   | % | 46,255       | 63.9   | % |
| LIFO (income)   | (286 )             | (0.5 ) | % | (929 )       | (1.3 ) | % |
| Overhead rate adjustments to inventory  | 62                 | 0.1    | % | 1,071        | 1.5    | % |
| Labor rate adjustments to inventory   | (78 )              | (0.1 ) | % | 289          | 0.4    | % |
| Product liability   | (253 )             | (0.4 ) | % | 654          | 0.9    | % |
| Product recall  | 10                 | -      |   | 18           | -      |   |
| Total cost of products sold   | 42,649             | 66.2   | % | 47,358       | 65.4   | % |
| Gross margin  | \$21,740           | 33.8   | % | \$25,032     | 34.6   | % |

|   | Six Months Ended |        |   |              |        |   |
|---|------------------|--------|---|--------------|--------|---|
|   | July 3, 2010     |        |   | July 4, 2009 |        |   |
| Net sales   | \$132,666        | 100.0  | % | \$135,920    | 100.0  | % |
| Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall | 88,905           | 67.0   | % | 88,979       | 65.5   | % |
| LIFO (income)   | (407 )           | (0.3 ) | % | (1,178 )     | (0.9 ) | % |
| Overhead rate adjustments to inventory  | (332 )           | (0.2 ) | % | 1,760        | 1.3    | % |
| Labor rate adjustments to inventory   | (134 )           | (0.1 ) | % | 457          | 0.3    | % |
| Product liability   | (263 )           | (0.2 ) | % | 747          | 0.6    | % |
| Product recall  | 25               | -      |   | 597          | 0.4    | % |
| Total cost of products sold   | 87,794           | 66.2   | % | 91,362       | 67.2   | % |
| Gross margin  | \$44,872         | 33.8   | % | \$44,558     | 32.8   | % |

Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall— During the three and six months ended July 3, 2010, cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall increased as a percentage of sales by 3.2% and 1.6% compared with the comparable 2009 periods. This increase was caused by the de-leveraging of fixed costs over lower sales and changes in product mix from the comparable 2009 periods.

LIFO— During the three months ended July 3, 2010, gross inventories increased by \$1.9 million and during the six months ended July 3, 2010, gross inventories decreased \$1.6 million. As a result, in the three and six months ended July 3, 2010 the Company recognized LIFO income resulting in decreased cost of products sold of \$0.3 million and \$0.4 million, respectively. In the comparable prior year periods, gross inventories decreased \$3.4 million and \$8.0 million, the Company recognized LIFO income resulting in decreased cost of products sold of \$0.9 million and \$1.2 million in the comparable 2009 periods.

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 months ended July 3, 2010, the Company was slightly 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 \$0.1 million. This decrease in inventory carrying values resulted in an increase to cost of products sold. During the six months ended July 3, 2010, the Company was less efficient in overhead spending and the overhead rates used to absorb overhead expenses into inventory increased, resulting in an increase in inventory value of \$0.3 million. This increase in inventory carrying values resulted in a decrease to cost of products sold.

During the comparable periods in 2009, the overhead rate used to absorb overhead into inventory decreased, resulting in a decrease in inventory value of \$1.1 million and \$1.8 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 and six months ended July 3, 2010, the Company was less efficient in direct labor utilization and the labor rates used to absorb incurred labor expenses into inventory increased, resulting in increases in inventory value of \$0.1 million. These increases in inventory carrying values resulted in decreases to cost of products sold.

During the comparable periods in 2009, the labor rates used to absorb incurred labor expenses into inventory decreased, resulting in a decrease in inventory value of \$0.3 million and \$0.5 million, respectively, and corresponding increases to cost of products sold.

Product Liability— Product liability expenses include the cost of outside legal fees, insurance, and other expenses incurred in the management and defense of product liability matters. The \$0.3 million reduction in cost of products sold for the three and six months ended July 3, 2010 was attributable to the favorable settlement of legal matters. See Note 9 to the notes to the financial statements “Contingent Liabilities” for further discussion of the Company’s product liability.

Product Recalls— In 2008, the Company received a small number of reports from the field that its SR9 pistols, and later, its LCP pistols, could discharge if dropped onto a hard surface. The Company began recalling SR9 pistols in April 2008 and LCP pistols in October 2008 to offer free safety retrofits. The estimated cost of these safety retrofit programs of approximately \$3.5 million was recorded in 2008. During the first quarter of 2009, it became apparent that the recalls were more successful than originally forecast and a greater quantity of affected pistols would be retrofitted than originally estimated. Therefore, an additional expense of \$0.6 million was recognized in the first quarter of 2009. Only modest retrofit expenses have been recorded since the first quarter of 2009.

**Gross Margin**—For the three and six months ended July 3, 2010, gross margin was \$21.7 million and \$44.9 million or 33.8% and 33.8% of sales. This is a decrease of \$3.3 million and an increase of \$0.3 million, respectively, or 13.2% and 1.0% from the comparable prior year periods' gross margin of \$25.0 million and \$44.6 million or 34.6% and 32.8% of sales.

### Selling, General and Administrative

Selling, general and administrative expenses were \$9.1 million and \$18.9 million or 14.1% and 14.3% of sales for the three and six months ended July 3, 2010. This represents a decrease of \$1.8 million and \$1.6 million from selling, general and administrative expenses of \$10.9 million and \$20.5 million or 15.0% and 15.1% of sales in the comparable prior year periods. These changes reflect decreased equity-based incentive compensation expenses.

### Other Operating Expenses

In the three and six months ended July 3, 2010, the Company recognized no expense and \$0.4 million, respectively, related to its frozen defined benefit pension plans, compared to \$0.2 million and \$0.7 million in the comparable prior year period.

### Other income

Other income was \$0.2 million in the three and six months ended July 3, 2010 compared to a break-even in the three and six months ended July 4, 2009.

### Income Taxes and Net Income

The effective income tax rate in the three and six months ended July 3, 2010 was 36.0%, compared to 38.0% for the comparable prior year periods. The decrease in the income tax rate results from an increased benefit from the American Jobs Creation Act of 2004 that was effective January 1, 2010.

As a result of the foregoing factors, consolidated net income was \$8.2 million and \$16.5 million for the three and six months ended July 3, 2010. This represents a decrease of \$0.5 million and an increase of \$2.0 million from consolidated net income of \$8.7 million and \$14.5 million in the comparable prior year periods.

### Financial Condition

#### Liquidity

At the end of the second quarter of 2010, the Company's cash, cash equivalents and short-term investments totaled \$58.7 million. Our pre-LIFO working capital of \$110.2 million, less the LIFO reserve of \$38.2 million, resulted in working capital of \$72.0 million and a current ratio of 4.0 to 1.

If the current demand subsides, the Company expects to replenish its finished goods inventory. This planned replenishment to levels that will better serve our customers could increase the FIFO value of finished goods inventory by as much as \$7 to \$10 million from current levels. The Company anticipates that the cash required to fund this increase in finished goods inventory would be partially offset by a reduction in accounts receivable which would be expected during a period of reduced demand.

During the first quarter of 2009, the Company paid down the \$1 million balance on its \$25 million credit facility, in response to the relative improvement in the global financial and credit markets. The credit facility, which expires on December 12, 2010, has remained unused since that time and the Company has no debt.

## Operations

Cash provided by operating activities was \$17.8 million for the six months ended July 3, 2010 compared to \$23.5 million for the comparable prior year period. The decrease in cash provided by operations is primarily attributable to a reduction in liabilities in the six months ended July 3, 2010 and greater inventory reduction in the six months ended July 4, 2009.

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 and shotgun 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 to provide ample 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 can not 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 six months ended July 3, 2010 totaled \$12.6 million. In 2010, the Company expects to spend approximately \$18 to \$20 million on capital expenditures to purchase tooling and manufacturing equipment for new product introductions, to upgrade and modernize manufacturing equipment, and to increase capacity for certain products in strong demand. The Company has financed all of these activities with cash provided by operations and current cash and short-term investments.

Dividends of \$2.9 million were paid during the six months ended July 3, 2010. The amounts of these dividends were based on a percentage of operating profit after adjustment for certain items, the same approach used by the Company since 2009. Under this approach, the amount per share of the quarterly dividend fluctuates directly with certain operating results of the Company. 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 cash. The Company has financed its dividends with cash provided by operations and current cash and short-term investments.

In February, 2010, the Board of Directors expanded the Company's authorization to repurchase shares of its common stock from \$4.7 million to \$10 million. To date, no share repurchases have been made since the \$10 million repurchase program was authorized.

In 2007, the Company amended its hourly and salaried defined benefit pension plans so that employees no longer accrue benefits under them effective December 31, 2007. This action "froze" the benefits for all employees and prevented future hires from joining the plans, effective December 31, 2007. Currently, the Company provides supplemental discretionary contributions to substantially all employees' individual 401(k) accounts.

The valuation of the future defined-benefit pension obligations at December 31, 2009 and 2008 indicated that these plans were underfunded by \$12.2 million and \$16.9 million, respectively, and resulted in a cumulative other comprehensive loss of \$20.4 million and \$23.0 million on the Company's balance sheet at December 31, 2009 and 2008, respectively.

Minimum cash contributions of \$1.7 million are required for the defined benefit plans for 2010. The Company voluntarily contributed \$2 million to the defined benefit plans in 2009 and plans on contributing approximately \$2 million in 2010.



In future years, the Company may be required to make cash contributions to the two defined benefit pension plans. The annual contributions will be based on the amount of the unfunded plan liabilities derived from the frozen benefits and will not include liabilities for any future accrued benefits for any new or existing participants. The total amount of these future cash contributions will depend on the investment returns generated by the plans' assets and the then-applicable discount rates used to calculate the plans' liabilities.

In the first quarter of 2009, the Company settled \$2.1 million of pension liabilities through the purchase of group annuities. This transaction resulted in an insignificant actuarial gain.

Based on its unencumbered assets, the Company believes it has the ability to raise substantial amounts of cash through issuance of short-term or long-term debt. During the first quarter of 2009, the Company paid down the \$1 million balance on its \$25 million credit facility, in response to the relative improvement in the global financial and credit markets. The credit facility, which expires on December 12, 2010, has remained unused since that time 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, waste disposal, air emissions and water discharges into the environment. In 2009, the Company was served with a complaint captioned Secretary of Labor v. Sturm, Ruger & Co. Inc. pending before the Occupational Safety and Health Review Commission. The complaint arose out of a Notice of Contest filed by the Company pursuant to an OSHA inspection conducted at the Company's manufacturing facility in Newport, New Hampshire. The matter was settled by agreement of the parties in December 2009. The Company believes that it is generally in compliance with applicable 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.

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 2009 Annual Report on Form 10-K filed on February 24, 2010, 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 including lawsuits filed by mayors, state attorneys general and other governmental entities and membership organizations, and the impact of future firearms control and environmental legislation, 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

The Company is exposed to changing interest rates on its investments, which consist 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 low, as the investments mature within short periods and the Company does not have significant exposure to changing interest rates on invested cash.

The Company has not undertaken any actions to cover interest rate market risk and is not a party to any interest rate market risk management activities.

A hypothetical ten percent change in market interest rates over the next year would not materially impact the Company's earnings or cash flows. A hypothetical ten percent change in market interest rates would not have a material effect on the fair value of the Company's investments.

### 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 July 3, 2010.

Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of July 3, 2010, such Disclosure Controls and Procedures are effective to 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 July 3, 2010 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 Company's 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.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The nature of the legal proceedings against the Company is discussed at Note 9 to this Form 10-Q report, which is incorporated herein by reference.

The Company has reported all cases instituted against it through April 3, 2010, and the results of those cases, where terminated, to the S.E.C. on its previous Form 10-Q and 10-K reports, to which reference is hereby made.

No cases were formally instituted against the Company during the three months ending July 3, 2010.

During the three months ending July 3, 2010, three previously reported cases were settled:

| Matter  | Jurisdiction | Date Settled   |
|---------|--------------|----------------|
| Gilbert | Kentucky     | April 26, 2010 |
| Lippard | Colorado     | May 21, 2010   |
| Ferebee | Washington   | June 29, 2010  |

The settlement amounts were within the limits of the Company's self-insurance coverage or self-insurance retention.

#### ITEM 1A. RISK FACTORS

There have been no material changes in our 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, 2009.

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

Not applicable

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The 2010 Annual Meeting of Stockholders of the Company was held on April 28, 2010. The table below sets forth the results of the votes taken on the 2010 Annual Meeting:

| 1. Election of Directors | Votes For  | Votes Withheld |
|--------------------------|------------|----------------|
| Michael O. Fifer         | 12,342,117 | 89,703         |
| C. Michael Jacobi        | 12,265,372 | 166,448        |
| John A. Cosentino, Jr.   | 12,339,057 | 92,763         |
| Amir P. Rosenthal        | 12,314,579 | 117,241        |
| James E. Service         | 12,299,255 | 132,565        |
| Ronald C. Whitaker       | 12,337,508 | 94,312         |
| Phillip C. Widman        | 12,333,562 | 98,258         |

2. Ratification of McGladrey & Pullen, LLP as Auditors for 2010

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| Votes For  | Votes Against | Abstain |
|------------|---------------|---------|
| 16,437,830 | 21,777        | 77,660  |

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

(a) Exhibits:

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

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STURM, RUGER & COMPANY, INC.

FORM 10-Q FOR THE THREE MONTHS ENDED JULY 3, 2010

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: July 27, 2010

S/THOMAS A. DINEEN  
Thomas A. Dineen  
Principal Financial Officer,  
Principal Accounting Officer,  
Vice President, Treasurer and Chief  
Financial Officer