STURM RUGER & CO INC
Form 10-K
February 20, 2019

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

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

(Mark One)

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

For the fiscal year ended December 31, 2018

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 0-4776

STURM, RUGER & COMPANY, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware **06-0633559**

(State or Other Jurisdiction of (I.R.S. Employer

Incorporation or Organization) Identification No.)

1 Lacey Place, Southport, Connecticut 06890

(Address of Principal Executive Offices) (Zip Code)

(203) 259-7843

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **YES_Ö NO __**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. **YES__ NO Ö**

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 filing requirements for the past 90 days. **YES Ö NO __**

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K **[Ö]**

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer **[Ö]** Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ].

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). **YES Ö NO ___**

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2018:

Common Stock, $1 par value - $958,787,400

The number of shares outstanding of the registrant's common stock as of February 14, 2019: *Common Stock, $1 par value –17,458,000 shares*

DOCUMENTS INCORPORATED BY REFERENCE.

Portions of the registrant's Proxy Statement relating to the 2019 Annual Meeting of Stockholders to be held May 8, 2019 are incorporated by reference into Part III (Items 10 through 14) of this Report.

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EXPLANATORY NOTE:

In this Annual Report on Form 10-K, Sturm, Ruger & Company, Inc. and Subsidiary (the "Company") makes 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. Words such as "expect," "believe," "anticipate," "intend," "estimate," "will," "should," "could" and other wor terms of similar meaning, typically identify such forward-looking statements. 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.

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PART I

ITEM 1—BUSINESS

Company Overview

Sturm, Ruger & Company, Inc. and Subsidiary (the “Company”) is principally engaged in the design, manufacture, and sale of firearms to domestic customers. Virtually all of the Company’s sales for the year ended December 31, 2018 were from the firearms segment, with approximately 1% from the castings segment. Export sales represent approximately 4% of firearms sales. The Company’s design and manufacturing operations are located in the United States and almost all product content is domestic.

The Company has been in business since 1949 and was incorporated in its present form under the laws of Delaware in 1969. The Company primarily offers products in three industry product categories – rifles, pistols, and revolvers. The Company’s firearms are sold through independent wholesale distributors, principally to the commercial sporting market.

The Company manufactures and sells investment castings made from steel alloys and metal injection molding (“MIM”) parts for internal use in the firearms segment and has minimal sales to outside customers. The castings and MIM parts sold to outside customers, either directly or through manufacturers’ representatives, represented approximately 1% of the Company’s total sales for the year ended December 31, 2018.

For the years ended December 31, 2018, 2017, and 2016, net sales attributable to the Company's firearms operations were $490.6 million, $517.7 million and $658.4 million. The balance of the Company's net sales for the aforementioned periods was attributable to its castings operations.

Firearms Products

The Company presently manufactures firearm products, under the “Ruger” name and trademark, in the following industry categories:

Rifles	Revolvers
· Single-shot	· Single-action
· Autoloading	· Double-action

- Bolt-action
- Modern sporting

Pistols

- Rimfire autoloading
- Centerfire autoloading

Most firearms are available in several models based upon caliber, finish, barrel length, and other features.

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Rifles

A rifle is a long gun with spiral grooves cut into the interior of the barrel to give the bullet a stabilizing spin after it leaves the barrel. Net sales of rifles by the Company accounted for $258.1 million, $243.0 million, and $264.9 million of total net sales for the years 2018, 2017, and 2016, respectively.

Pistols

A pistol is a handgun in which the ammunition chamber is an integral part of the barrel and which typically is fed ammunition from a magazine contained in the grip. Net sales of pistols by the Company accounted for $144.3 million, $176.2 million, and $250.0 million of revenues for the years 2018, 2017, and 2016, respectively.

Revolvers

A revolver is a handgun that has a cylinder that holds the ammunition in a series of chambers which are successively aligned with the barrel of the gun during each firing cycle. There are two general types of revolvers, single-action and double-action. To fire a single-action revolver, the hammer is pulled back to cock the gun and align the cylinder before the trigger is pulled. To fire a double-action revolver, a single trigger pull advances the cylinder and cocks and releases the hammer. Net sales of revolvers by the Company accounted for $63.3 million, $74.6 million, and $104.9 million of revenues for the years 2018, 2017, and 2016, respectively.

Accessories

The Company also manufactures and sells accessories and replacement parts for its firearms. These sales accounted for $25.0 million, $23.9 million, and $38.6 million of total net sales for the years 2018, 2017, and 2016, respectively.

Castings Products

Net sales attributable to the Company’s casting operations (excluding intercompany transactions) accounted for $5.0 million, $4.6 million, and $5.9 million, for 2018, 2017, and 2016, respectively. These sales represented approximately 1% of total net sales in each of these years.

Manufacturing

Firearms

The Company produces one model of pistol, all of its revolvers and most of its rifles at the Newport, New Hampshire facility. Most of the Company’s pistols are produced at the Prescott, Arizona facility. Some rifle models and pistol models are produced at the Mayodan, North Carolina facility.

Many of the basic metal component parts of the firearms manufactured by the Company are produced by the Company's castings segment through processes known as precision investment casting. The Company also uses many MIM parts in its firearms. See "Manufacturing- Investment Castings and Metal Injected Moldings" below for a description of these processes. The Company believes that investment castings and MIM parts provide greater design flexibility and result in component parts which are generally close to their ultimate shape and, therefore, require less machining than processes requiring machining a solid billet of metal to obtain a part.

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Through the use of investment castings and MIM parts, the Company endeavors to produce durable and less costly component parts for its firearms.

All assembly, inspection, and testing of firearms manufactured by the Company are performed at the Company's manufacturing facilities. Every firearm, including every chamber of every revolver manufactured by the Company, is test-fired prior to shipment.

Investment Castings and Metal Injection Moldings

To produce a product by the investment casting method, a wax model of the part is created and coated (“invested”) with several layers of ceramic material. The shell is then heated to melt the interior wax, which is poured off, leaving a hollow mold. To cast the desired part, molten metal is poured into the mold and allowed to cool and solidify. The mold is then broken off to reveal a near net shape cast metal part.

Metal injection molding is a three part powder metallurgy process by which a feedstock consisting of finely powdered metal and binders is processed through injection molding, debinding, and sintering equipment to produce steel, stainless steel, and alloy parts of complex shape and geometry. This process allows for high volume production while eliminating many of the wastes of traditional metal working methods, yielding net shape and near net shape parts.

Marketing and Distribution

Firearms

The Company's firearms are primarily marketed through a network of federally licensed, independent wholesale distributors who purchase the products directly from the Company. They resell to federally licensed, independent retail firearms dealers who in turn resell to legally authorized end users. All retail purchasers are subject to a point-of-sale background check by law enforcement. These end users include sportsmen, hunters, people interested in self-defense, law enforcement and other governmental organizations, and gun collectors. Each domestic distributor carries the entire line of firearms manufactured by the Company for the commercial market. Currently, 19 distributors service the domestic commercial market, with an additional 23 distributors servicing the domestic law enforcement market and 41 distributors servicing the export market.

In 2018, the Company’s largest customers and the percent of firearms sales they represented were as follows: Davidson’s-21%; Lipsey’s-20%; and Sports South-16%.

In 2017, the Company's largest customers and the percent of firearms sales they represented were as follows: Davidson's-21%; Lipsey's-18%; Sports South-13%; and Jerry's/Ellett Brothers-12%.

In 2016, the Company's largest customers and the percent of firearms sales they represented were as follows: Davidson's-19%; Lipsey's-17%; Jerry's/Ellett Brothers-15%; and Sports South-14%.

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The Company employs 14 employees who service these distributors and call on retailers and law enforcement agencies. Because the ultimate demand for the Company's firearms comes from end users rather than from the independent wholesale distributors, the Company believes that the loss of any distributor would not have a material, long-term adverse effect on the Company, but may have a material adverse effect on the Company’s financial results for a particular period. The Company considers its relationships with its distributors to be satisfactory.

The Company also exports its firearms through a network of selected commercial distributors and directly to certain foreign customers, consisting primarily of law enforcement agencies and foreign governments. Foreign sales were less than 5% of the Company's consolidated net sales for each of the past three fiscal years.

The Company does not consider its overall firearms business to be predictably seasonal; however, orders of many models of firearms from the 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.

Investment Castings and Metal Injection Moldings

The castings segment provides castings and MIM parts for the Company’s firearms segment. In addition, the castings segment produces some products for a number of customers in a variety of industries.

Competition

Firearms

Competition in the firearms industry is intense and comes from both foreign and domestic manufacturers. While some of these competitors concentrate on a single industry product category such as rifles or pistols, several competitors manufacture products in all four industry categories (rifles, shotguns, pistols, and revolvers). The principal methods of competition in the industry are product innovation, quality, availability, brand, and price. The Company believes that it can compete effectively with all of its present competitors.

Investment Castings and Metal Injection Moldings

There are a large number of investment castings and MIM manufacturers, both domestic and foreign, with which the Company competes. Competition varies based on the type of investment castings products and the end use of the product. Companies offering alternative methods of manufacturing such as wire electric discharge machining (EDM) and advancements in computer numeric controlled (CNC) machining also compete with the Company’s castings segment. Many of these competitors are larger corporations than the Company with substantially greater financial resources than the Company, which could affect the Company’s ability to compete with these competitors. The principal methods of competition in the industry are quality, price, and production lead time.

Employees

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As of February 1, 2019, the Company employed approximately 1,830 full-time employees, approximately 28% of whom had at least ten years of service with the Company. From time to time, the Company uses temporary employees to supplement its workforce. As of February 1, 2019, the Company did not have any temporary employees.

None of the Company's employees are subject to a collective bargaining agreement.

Research and Development

In 2018, 2017, and 2016, the Company spent approximately $8.5 million, $9.8 million, and $8.7 million, respectively, on research and development activities relating to new products and the improvement of existing products. As of February 1, 2019, the Company had approximately 70 employees whose primary responsibilities were research and development activities.

Patents and Trademarks

The Company owns various United States and foreign patents and trademarks which have been secured over a period of years and which expire at various times. It is the policy of the Company to apply for patents and trademarks whenever new products or processes deemed commercially valuable are developed or marketed by the Company. However, none of these patents and trademarks are considered to be fundamental to any important product or manufacturing process of the Company and, although the Company deems its patents and trademarks to be of value, it does not consider its business materially dependent on patent or trademark protection.

Environmental Matters

The Company is committed to achieving high standards of environmental quality and product safety, and strives to provide a safe and healthy workplace for its employees and others in the communities in which it operates. The Company has programs in place that monitor compliance with various environmental regulations. However, in the normal course of its manufacturing operations the Company is subject to governmental proceedings and orders pertaining to waste disposal, air emissions, and water discharges into the environment. These regulations are integrated into the Company’s manufacturing, assembly, and testing processes. The Company believes that it is generally in compliance with applicable environmental regulations and that the outcome of any environmental proceedings and orders will not have a material adverse effect on the financial position of the Company, but could have a material adverse effect on the financial results for a particular period.

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Executive Officers of the Company

Set forth below are the names, ages, and positions of the executive officers of the Company. Officers serve at the discretion of the Board of Directors of the Company.

Name	Age	Position With Company
Christopher J. Killoy	60	President and Chief Executive Officer
Thomas A. Dineen	50	Senior Vice President, Treasurer, and Chief Financial Officer
Thomas P. Sullivan	58	Senior Vice President of Operations
Kevin B. Reid, Sr.	58	Vice President, General Counsel, and Corporate Secretary
Shawn C. Leska	47	Vice President, Sales

Christopher J. Killoy became President & Chief Executive Officer on May 9, 2017. Previously he served as President and Chief Operating Officer since January 1, 2014. Prior to that he served as Vice President of Sales and Marketing since November 27, 2006. Mr. Killoy originally joined the Company in 2003 as Executive Director of Sales and Marketing, and subsequently served as Vice President of Sales and Marketing from November 1, 2004 to January 25, 2005.

Thomas A. Dineen became Senior Vice President on July 10, 2017. Previously he served as Vice President since May 24, 2006. Prior to that he served as Treasurer and Chief Financial Officer since May 6, 2003 and had been Assistant Controller since 2001. Mr. Dineen joined the Company as Manager, Corporate Accounting in 1997.

Thomas P. Sullivan became Senior Vice President of Operations on July 1, 2017. Mr. Sullivan joined the Company as Vice President of Newport Operations for the Newport, New Hampshire Firearms and Pine Tree Castings divisions on August 14, 2006.

Kevin B. Reid, Sr. became Vice President and General Counsel on April 23, 2008. Previously he served as the Company's Director of Marketing from June 4, 2007. Mr. Reid joined the Company in July 2001 as an Assistant General Counsel.

Shawn C. Leska became Vice President, Sales on November 6, 2015. Mr. Leska joined the Company in 1989 and has served in a variety of positions in the sales department. Most recently, Mr. Leska served as Director of Sales since 2011.

Where You Can Find More Information

The Company is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and accordingly, files its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Definitive Proxy Statements, Current Reports on Form 8-K,

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and other information with the Securities and Exchange Commission (the "SEC"). As an electronic filer, the Company's public filings are maintained on the SEC's Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of that website is http://www.sec.gov.

The Company makes its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Definitive Proxy Statements, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act accessible free of charge through the Company's Internet site after the Company has electronically filed such material with, or furnished it to, the SEC. The address of that website is http://www.ruger.com. However, such reports may not be accessible through the Company's website as promptly as they are accessible on the SEC’s website.

Additionally, the Company’s corporate governance materials, including its Corporate Governance Guidelines, the charters of the Audit, Compensation, Nominating and Corporate Governance, and Risk Oversight committees, and the Code of Business Conduct and Ethics may also be found under the “Investor Relations” subsection of the “Corporate” section of the Company’s Internet site at http://www.ruger.com/corporate. A copy of the foregoing corporate governance materials is available upon written request to the Corporate Secretary at Sturm, Ruger & Company, Inc., 1 Lacey Place, Southport, Connecticut 06890.

ITEM 1A—RISK FACTORS

The Company’s operations could be affected by various risks, many of which are beyond its control. Based on current information, the Company believes that the following identifies the most significant risk factors that could adversely affect its business. Past financial performance may not be a reliable indicator of future performance and historical trends should not be used to anticipate results or trends in future periods.

In evaluating the Company’s business, the following risk factors, as well as other information in this report, should be carefully considered.

Changes in government policies and firearms legislation could adversely affect the Company’s financial results.

The sale, purchase, ownership, and use of firearms are subject to thousands of federal, state and local governmental regulations. The basic federal laws are the National Firearms Act, the Federal Firearms Act, and the Gun Control Act of 1968. These laws generally prohibit the private ownership of fully automatic weapons manufactured after 1986 and place certain restrictions on the interstate sale of firearms unless certain licenses are obtained. The Company does not manufacture fully automatic weapons and holds all necessary licenses under these federal laws. Several states currently have laws in effect similar to the aforementioned legislation.

In 2005, Congress enacted the Protection of Lawful Commerce in Arms Act ("PLCAA"). The PLCAA was enacted to address abuses by cities and agenda-driven individuals who wrongly sought to make firearms manufacturers liable for legally manufactured and lawfully sold

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products if those products were later used in criminal acts. The Company believes the PLCAA merely codifies common sense and long standing tort principles. If the PLCAA is repealed or efforts to circumvent it are successful and lawsuits similar to those filed by cities and agenda-driven individuals in the late 1990s and early 2000s are allowed to proceed, it could have a material adverse impact on the Company.

Currently, federal and several states' legislatures are considering additional legislation relating to the regulation of firearms. These proposed bills are extremely varied, but many seek either to restrict or ban the sale and, in some cases, the ownership of various types of firearms. Other legislation seeks to require new technologies, such as microstamping and so-called "smart gun" technology, that are not proven, reliable or feasible. Such legislation became effective in California in 2013, and has limited our ability to sell certain products in California. If similar legislation is enacted in other states, it could effectively ban or severely limit the sale of affected firearms. There also are legislative proposals to limit magazine capacity.

The Company believes that the lawful private ownership of firearms is guaranteed by the Second Amendment to the United States Constitution and that the widespread private ownership of firearms in the United States will continue. However, there can be no assurance that the regulation of firearms will not become more restrictive in the future and that any such restriction would not have a material adverse effect on the business of the Company.

The Company's results of operations could be further adversely affected if legislation with diverse requirements is enacted.

With literally thousands of laws being proposed at the federal, state and local levels, if even a small percentage of these laws are enacted and they are incongruent, the Company could find it difficult, expensive or even practically impossible to comply with them, impeding new product development and distribution of existing products.

The Company's results of operations could be adversely affected by litigation.

The Company faces risks arising from various asserted and unasserted litigation matters. These matters include, but are not limited to, assertions of allegedly defective product design or manufacture, alleged failure to warn, purported class actions against firearms manufacturers, generally seeking relief such as medical expense reimbursement, property damages, and punitive damages arising from accidents involving firearms or the criminal misuse of firearms, and those lawsuits filed on behalf of municipalities alleging harm to the general public. Various factors or developments can lead to changes in current estimates of liabilities such as final adverse judgment, significant settlement or changes in applicable law. A future adverse outcome in any one or more of these matters could have a material adverse effect on the Company's financial results. See Note 18 to the financial statements which are included in this Annual Report on Form 10-K.

Our insurance may be insufficient to protect us from claims or losses.

We maintain insurance coverage with third-party insurers. However, not every risk or liability is or can be protected by insurance, and, for those risks we insure, the limits of coverage we purchase or that are reasonably obtainable in the market may not be sufficient to cover all actual losses or liabilities incurred. Moreover, there is a risk that commercially available liability

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insurance will not continue to be available to us at a reasonable cost, if at all. If liability claims or losses exceed our current or available insurance coverage, our business and prospects may be harmed.

The Company's results of operations could be adversely affected by a decrease in demand for Company products.

If demand for the Company's products decreases significantly, the Company would be unable to efficiently utilize its capacity, and profitability would suffer. Decreased demand could result from a macroeconomic downturn, or could be specific to the firearms industry. If the decrease in demand occurs abruptly, the adverse impact would be even greater.

The financial health of our independent distributors is critical to our success.

Over 90% of our sales are made to 19 federally licensed, independent wholesale distributors. We review our distributors' financial statements and have credit insurance for many of them. However, our credit evaluations of distributors and credit insurance may not be completely effective, especially if an interest rate increase exacts an additional financial strain.

If one or more independent distributors experience financial distress or liquidity issues, we may not be able to collect our accounts receivable on a timely basis, which would have an adverse impact on our operating results and financial condition.

The Company must comply with various laws and regulations pertaining to workplace safety and environment, environmental matters, and firearms manufacture.

In the normal course of its manufacturing operations, the Company is subject to numerous federal, state and local laws and governmental regulations, and governmental proceedings and orders. These laws and regulations pertain to matters like workplace safety and environment, firearms serial number tracking and control, waste disposal, air emissions and water discharges into the environment. Noncompliance with any one or more of these laws and regulations could have a material adverse impact on the Company.

Misconduct of our employees or contractors could cause us to lose customers and could have a significant adverse impact on our business and reputation.

Misconduct, fraud or other improper activities by our employees or contractors could have a material adverse impact on our business and reputation. Such misconduct could include the failure to comply with federal, state, local or foreign government procurement regulations, regulations regarding the protection of personal information, laws and regulations relating to antitrust and any other applicable laws or regulations.

Business disruptions at one of the Company’s manufacturing facilities could adversely affect the Company’s financial results.

The Newport, New Hampshire, Prescott, Arizona and Mayodan, North Carolina facilities are critical to the Company’s success. These facilities house the Company’s principal production, research, development, engineering, design, and shipping operations. Any event that causes a disruption of the operation of any of these facilities for even a relatively short period of time could have a material adverse effect on the Company’s ability to produce and ship products and to provide service to its customers.

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We rely on our information and communications systems in our operations. Security breaches and other disruptions could adversely affect our business and results of operations.

Cyber-security threats are significant and evolving and include, among others, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in mission critical systems, unauthorized release of confidential or otherwise protected information and corruption of data. In addition to security threats, we are also subject to other systems failures, including network, software or hardware failures, whether caused by us, third-party service providers, natural disasters, power shortages, terrorist attacks or other events. The unavailability of our information or communications systems, the failure of these systems to perform as anticipated or any significant breach of data security could cause loss of data, disrupt our operations, lead to financial losses from remedial actions, require significant management attention and resources, and negatively impact our reputation among our customers and the public, which could have a negative impact on our financial condition, results of operations and liquidity.

Price increases for raw materials could adversely affect the Company's financial results.

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 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 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.

Retention of key management is critical to the success of the Company.

We rely on the management and leadership skills of our senior management team. Our senior executives are not bound by employment agreements. The loss of the services of one or more of our senior executives or other key personnel could have a significant adverse impact on our business.

ITEM 1B—UNRESOLVED STAFF COMMENTS

None

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ITEM 2—PROPERTIES

The Company's manufacturing operations are carried out at four facilities. The following table sets forth certain information regarding each of these facilities:

	Approximate Aggregate Usable Square Feet	Status	Segment
Newport, New Hampshire	350,000	Owned	Firearms/Castings
Prescott, Arizona	230,000	Leased	Firearms
Mayodan, North Carolina	220,000	Owned	Firearms
Earth City, Missouri	35,000	Leased	Castings

Each firearms facility contains enclosed ranges for testing firearms. The lease of the Prescott facility provides for rental payments which are approximately equivalent to estimated rates for real property taxes.

The Company has other facilities that were not used in its manufacturing operations in 2018:

	Approximate Aggregate Usable Square Feet	Status	Segment
Southport, Connecticut	25,000	Owned	Corporate
Newport, New Hampshire (Dorr Woolen Building)	45,000	Owned	Firearms
Enfield, Connecticut	10,000	Leased	Firearms
Rochester, New Hampshire	2,000	Leased	Firearms

Fairport, New York	3,700	Leased	Corporate

There are no mortgages or any other major encumbrance on any of the real estate owned by the Company.

The Company’s principal executive offices are located in Southport, Connecticut.

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ITEM 3—LEGAL PROCEEDINGS

The nature of the legal proceedings against the Company is discussed at Note 18 to the financial statements, which are included in this Form 10-K.

The Company has reported all cases instituted against it through September 29, 2018, 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.

Two lawsuits were formally instituted against the Company during the three months ending December 31, 2018. *Lora Testerman vs. Sturm, Ruger & Co., Inc., et al*, was filed in the Smyth County General District Court in Virginia. The matter of *Clifton Reece McKelva v. Sturm, Ruger & Co., Inc., et al*, was filed in Bosque County, Texas on November 19, 2018, though the Petition was not served on the Company until January 11, 2019.

ITEM 4—MINE SAFETY DISCLOSURES – NOT APPLICABLE

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PART II

ITEM 5— MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock is traded on the New York Stock Exchange under the symbol "RGR." At February 8, 2019, the Company had 1,662 stockholders of record.

Issuer Repurchase of Equity Securities

In 2017 and 2016 the Company repurchased shares of its common stock. In 2018, the Company did not repurchase any shares of its common stock. Details of the purchases in 2016 and 2017 are as follows:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program
Fourth Quarter 2016	283,343	$ 49.43	283,343	
First Quarter 2017				
January 29 to February 25	900,997	$ 49.70	900,997	
February 26 to April 1	173,288	$ 49.92	173,288	
Third Quarter 2017				
July 30 to August 26	4,490	$ 47.92	4,490	
August 27 to September 30	240,933	$ 46.30	240,933	
Total	1,603,051	$ 49.16	1,603,051	$ 88,710,000

All of these purchases were made with cash held by the Company and no debt was incurred.

At December 31, 2018 approximately $89 million remained authorized for share repurchases.

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Comparison of Five-Year Cumulative Total Return*
Sturm, Ruger & Co., Inc., Standard & Poor's 500, Recreation and Russell 2000 Index
(Performance Results Through 12/31/18)

Assumes $100 invested at the close of trading 12/13 in Sturm, Ruger & Co., Inc. common stock, Standard & Poor's 500, Recreation, and Russell 2000 Index.

* Cumulative total return assumes reinvestment of dividends.

Source: Value Line Publishing LLC

	2013	2014	2015	2016	2017	2018
Sturm, Ruger & Co., Inc.	100.00	48.76	85.61	77.76	84.48	82.07
Standard & Poor's 500	100.00	113.69	115.27	129.06	157.23	150.34
Recreation	100.00	113.97	129.33	140.09	168.41	147.77
Russell 2000 Index	100.00	104.89	100.26	121.63	139.45	124.10

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information regarding compensation plans under which equity securities of the Company are authorized for issuance as of December 31, 2018:

Equity Compensation Plan Information

Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights** **(a)**	**Weighted-average exercise price of outstanding options, warrants and rights** **(b) ***	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))** **(c)**
Equity compensation plans approved by security holders			
			—
2007 Stock Incentive Plan	**192,887**	**$9.60 per share**	—
2017 Stock Incentive Plan	**190,553**	**—**	**542,928**
Equity compensation plans not approved by security holders			
None.			
Total	**383,440**	**$9.60 per share**	**542,928**

* Restricted stock units are settled in shares of common stock on a one-for-one basis. Accordingly, such units have been excluded for purposes of computing the weighted-average exercise price.

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ITEM 6—SELECTED FINANCIAL DATA

(Dollars in thousands, except per share data)

December 31,	2018	2017	2016	2015	2014
Net firearms sales	490,607	$517,701	$658,433	$544,850	$542,267
Net castings sales	5,028	4,555	5,895	6,244	2,207
Total net sales	495,635	522,256	664,328	551,094	544,474
Cost of products sold	361,277	368,248	444,774	378,934	375,300
Gross profit	134,358	154,008	219,554	172,160	169,174
Income before income taxes	68,714	77,646	135,921	96,100	57,240
Income taxes	17,781	25,504	48,449	33,974	18,612
Net income	50,933	52,142	87,472	62,126	38,628
Basic earnings per share	2.92	2.94	4.62	3.32	1.99
Diluted earnings per share	2.88	2.91	4.59	3.21	1.95
Cash dividends per share	$1.10	$1.36	$1.73	$1.10	$1.62

December 31,	2018	2017	2016	2015	2014
Working capital	$160,998	$114,107	$133,870	$107,279	$57,792
Total assets	335,532	284,318	346,879	315,883	254,382
Total stockholders’ equity	264,242	230,149	265,900	227,738	185,462
Book value per share	$15.14	$13.21	$14.23	$12.17	$9.90
Return on stockholders’ equity	20.6 %	21.0 %	35.4 %	30.1 %	21.2 %
Current ratio	3.3 to 1	3.2 to 1	2.7 to 1	2.3 to 1	2.0 to 1
Common shares outstanding	17,458,000	17,427,100	18,688,500	18,713,400	18,737,000
Number of stockholders of record	1,652	1,664	1,678	1,702	1,726
Number of employees	1,811	1,838	2,120	1,920	1,847
Number of temporary employees	11	2	310	205	220

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ITEM 7— 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 4% 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. Approximately 1% of sales are from the castings segment.

Orders of 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 - 2018

Product Demand

The estimated sell-through of the Company’s products from the independent distributors to retailers in 2018 was essentially unchanged from 2017. For the same period, the National Instant Criminal Background Check System (“NICS”) background checks (as adjusted by the National Shooting Sports Foundation (“NSSF”)) decreased 6%. Despite the apparent reduction in overall industry demand, as reflected by the NICS data, the estimated sell-through of the Company’s products from the independent distributors to retailers remained consistent with the prior year due to strong demand for some of the Company’s products, particularly those that were introduced in December 2017.

New products represented $145.6 million or 30% of firearms sales in 2018, compared to $137.8 million or 27% of firearms sales in 2017. New product sales include only major new products that were introduced in the past two years. In 2018, new products included the Pistol Caliber Carbine, the Precision Rimfire Rifle, the Mark IV pistol, the LCP II pistol, the Security-9 pistol, and the EC9s pistol.

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Estimated sell-through from distributors to retailers and total adjusted NICS background checks:

	2018	2017	2016
Estimated Units Sold from Distributors to Retailers (1)	1,654,600	1,663,100	2,007,200
Total Adjusted NICS Background Checks (2)	13,116,000	13,967,800	15,727,700

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

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

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

The adjusted NICS data presented above was derived by the NSSF by subtracting 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.

Orders Received in 2018 increased 11% from 2017. Our ending order backlog of 153,000 units at December 31, 2018 decreased 101,900 units from backlog of 254,900 units at December 31, 2017.

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The units ordered, value of orders received and ending backlog, net of Federal Excise Tax, for the trailing three years are as follows (dollars in millions, except average sales price):

	2018	2017	2016
Orders Received	$430.0	$386.2	$688.5
Average Sales Price of Orders Received	$281	$297	$306
Ending Backlog	$55.6	$75.4	$195.0
Average Sales Price of Ending Backlog	$364	$296	$314

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 and manage increases in inventory. Total unit production in 2018 was materially unchanged from 2017.

Annual Summary Unit Data

Firearms unit data for orders, production, and shipments follows:

	2018	2017	2016
Units Ordered	1,531,100	1,298,800	2,246,600
Units Produced	1,610,300	1,610,900	2,125,500
Units Shipped	1,633,000	1,665,300	2,055,500
Average Sales Price	$300	$311	$320
Units – Backlog	153,000	254,900	621,400

Inventories

The Company’s finished goods inventory decreased by 22,600 units during 2018.

Distributor inventories of the Company’s products decreased by 21,600 units during 2018 and approximate a reasonable level to support rapid fulfillment of retailer demand. In the aggregate, total Company and distributor inventories decreased by 10% in 2018.

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Inventory data follows:

	December 31, 2018	2017	2016
Units – Company Inventory	80,300	102,900	157,400
Units – Distributor Inventory (3)	299,700	321,300	319,300
Total inventory (4)	380,000	424,200	476,700

(3) Distributor ending inventory as provided by the independent distributors of the Company's products. These numbers do not include goods-in-transit inventory that has been shipped from the Company but not yet received by the distributors.

(4) This total does not include inventory at retailers. The Company does not have access to data on retailer inventories.

Year ended December 31, 2018, as compared to year ended December 31, 2017:

Net Sales

Consolidated net sales were $495.6 million in 2018. This represents a decrease of $26.7 million or 5.1% from 2017 consolidated net sales of $522.3 million.

Firearms segment net sales were $490.6 million in 2018. This represents a decrease of $27.1 million or 5.2% from 2017 firearms net sales of $517.7 million. Firearms unit shipments decreased 1.9% in 2018.

Casting segment net sales were $5.0 million in 2018. This represents an increase of $0.4 million or 10.4% from 2017 casting sales of $4.6 million.

Cost of Products Sold and Gross Profit

Consolidated cost of products sold was $361.3 million in 2018. This represents a decrease of $6.9 million or 1.9% from 2017 consolidated cost of products sold of $368.2 million.

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The gross margin was 27.1% in 2018. This represents a decrease from 29.5% in 2017 as illustrated below:

(in thousands)				
Year Ended December 31,	2018		2017	
Net sales	$495,635	100.0%	$522,256	100.0%
Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product safety bulletins and recalls	354,997	71.6 %	367,551	70.4 %
LIFO expense	1,882	0.4 %	2,639	0.5 %
Overhead rate adjustments to inventory	1,777	0.4 %	(4,423)	(0.9)%
Labor rate adjustments to inventory	193	—	(379)	(0.1)%
Product liability	1,514	0.3 %	360	0.1 %
Product safety bulletins and recalls	914	0.2 %	2,500	0.5 %
Total cost of products sold	361,277	72.9 %	368,248	70.5 %
Gross profit	$134,358	27.1 %	$154,008	29.5 %

Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product safety bulletins and recalls- In 2018, cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability increased 1.2% as a percentage of sales compared to 2017. This increase was due primarily to the adoption of ASC 606, which resulted in $12.1 million of promotional expenses that had been classified as selling expenses in prior years being included in cost of products sold in 2018.

LIFO- The Company recognized LIFO expense in 2018 and 2017 of $1.9 million and $2.6 million, respectively, which increased cost of products sold in both periods.

Overhead Rate Change- The net impact on inventory in 2018 and 2017 from the change in the overhead rates used to absorb overhead expenses into inventory was a decrease of $1.8 million and an increase of $4.4 million, respectively, reflecting increased overhead efficiency in 2018 and decreased overhead efficiency in 2017. The decrease in inventory value in 2018 resulted in a corresponding increase to cost of products sold and the increase in inventory value in 2017 resulted in a corresponding decrease to cost of products sold.

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Labor Rate Adjustments- In 2018, the change in inventory value resulting from the change in the labor rates used to absorb labor expenses into inventory was a decrease of $0.2 million, reflecting increased labor efficiency. This decrease in inventory value resulted in a corresponding increase to cost of products sold. In 2017, the change in inventory value resulting from the change in the labor rates used to absorb labor expenses into inventory was an increase of $0.4 million, reflecting decreased labor efficiency. This increase in inventory value resulted in a corresponding decrease 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. These costs totaled $1.5 million and $0.4 million in 2018 and 2017, respectively. See Note 18 in the notes to the financial statements "Contingent Liabilities" for further discussion of the Company's product liability.

Product Safety Bulletins and Recalls- In October 2018, the Company issued a safety bulletin announcing that some Ruger American Pistols chambered in 9mm may exhibit premature wear of the locking surfaces between the slide and barrel. The Company offered a free retrofit to customers of affected pistols and recorded a $1.0 million expense in the third quarter of 2018, which was the expected total cost of the safety bulletin.

In June 2017, the Company discovered that Mark IV pistols manufactured prior to June 1, 2017 had the potential to discharge unintentionally if the safety was not utilized correctly. The Company recalled all Mark IV pistols and recorded a $2.5 million expense in the second quarter, which is the expected total cost of the recall. Also, the Company issued a Product Safety Bulletin for certain Ruger Precision Rifles due to the potential for interference between the aluminum bolt shroud and the cocking piece and recorded a $0.2 million expense in the third quarter of 2017.

Gross Profit- Gross profit was $134.4 million or 27.1% of sales in 2018. This is a decrease of $19.6 million from 2017 gross profit of $154.0 million or 29.5% of sales in 2017.

Selling, General and Administrative

Selling, general and administrative expenses were $67.4 million in 2018, a decrease of $10.2 million from $77.6 million in 2017, and a decrease from 14.9% of sales in 2017 to 13.6% of sales in 2018. These decreases were primarily attributable to reductions in firearms promotional expense. Effective January 1, 2018, the Company adopted ASC 606 which modified revenue recognition related to certain sales promotion activities that include the shipment of no charge firearms. As a result, approximately $12.1 million of promotional expenses that had been classified as selling expenses in prior years are recorded as cost of products sold in 2018.

Other Operating Income, net

Other operating income, net was de minimis in 2018 and 2017.

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Operating Income

Operating income was $67.0 million or 13.5% of sales in 2018. This is a decrease of $9.3 million from 2017 operating income of $76.3 million or 14.6% of sales.

Royalty Income

Royalty income was $0.8 million in 2018 and $0.5 million in 2017.

Interest Income and Interest Expense

Interest income and interest expense were insignificant in 2018 and 2017.

Other Income, Net

Other income, net was $1.0 million in 2018, an increase of $0.1 million from $0.9 million in 2017.

Income Taxes and Net Income

The effective income tax rate was 25.9% in 2018 and 32.8% in 2017. The decrease in the effective tax rate in 2018 is primarily attributable to the “2017 Tax Cuts and Jobs Act” which reduced the Federal corporate income tax rate to 21% beginning in 2018.

As a result of the foregoing factors, consolidated net income was $50.9 million in 2018. This represents a decrease of $1.2 million from 2017 consolidated net income of $52.1 million.

Non-GAAP Financial Measure

In an effort to provide investors with additional information regarding its 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 measure may not be comparable to similarly titled measures being disclosed by other companies. In addition, the Company believes that the non-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.

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Non-GAAP Reconciliation – EBITDA

EBITDA

(Unaudited, dollars in thousands)

Year ended December 31,	2018	2017
Net income	$50,933	$52,142
Income tax expense	17,781	25,504
Depreciation and amortization expense	31,972	34,264
Interest expense	330	152
Interest income	(211)	(27)
EBITDA	$100,805	$112,035

EBITDA is defined as earnings before interest, taxes, and depreciation and amortization. The Company calculates this 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 to arrive at EBITDA. The Company’s EBITDA calculation also excludes any one-time non-cash, non-operating expense.

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Quarterly Data

To supplement the summary annual unit data and discussion above, the same data for the last eight quarters follows:

	2018 Q4	Q3	Q2	Q1
Units Ordered	312,800	237,800	344,600	635,900
Units Produced	402,400	404,200	415,200	388,500
Units Shipped	394,800	386,200	411,600	440,400
Estimated Units Sold from Distributors to Retailers	400,000	364,000	381,100	509,500
Total Adjusted NICS Background Checks	3,813,000	2,708,000	2,863,000	3,731,000
Average Unit Sales Price	$304	$295	$309	$295
Units – Backlog	153,000	235,000	383,400	450,400
Units – Company Inventory	80,300	72,700	54,700	51,000
Units – Distributor Inventory (5)	299,700	304,800	282,700	252,300

	2017 Q4	Q3	Q2	Q1
Units Ordered	467,500	221,900	214,400	395,000
Units Produced	320,800	327,300	432,900	529,900
Units Shipped	383,200	329,100	432,000	521,000
Estimated Units Sold from Distributors to Retailers	425,600	341,300	362,400	533,800
Total Adjusted NICS Background Checks	4,210,000	2,948,000	3,116,000	3,694,000

Average Unit Sales Price	$306	$315	$302	$319
Units – Backlog	254,900	170,600	277,800	495,400
Units – Company Inventory	102,900	165,400	167,200	166,200
Units – Distributor Inventory (5)	321,300	363,800	376,000	306,400

(5) Distributor ending inventory as provided by the independent distributors of the Company's products.

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(in millions except average sales price, net of Federal Excise Tax)

	2018 Q4	Q3	Q2	Q1
Orders Received	$92.9	$66.6	$95.4	$175.1
Average Sales Price of Orders Received	$297	$280	$277	$275
Ending Backlog	$55.6	$81.5	$125.0	$149.2
Average Sales Price of Ending Backlog	$364	$347	$326	$331

	2017 Q4	Q3	Q2	Q1
Orders Received	$129.0	$62.9	$62.4	$131.9
Average Sales Price of Orders Received	$276	$283	$291	$334
Ending Backlog	$75.4	$56.6	$95.0	$163.8
Average Sales Price of Ending Backlog	$296	$332	$342	$331

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Fourth Quarter Gross Profit Analysis

The gross margin for the fourth quarter of 2018 and 2017 was 27.9% and 28.0%, respectively. Details of the gross margin are illustrated below:

(in thousands)

Three Months Ended December 31,	2018		2017	
Net sales	$121,121	100.0%	$118,230	100.0%
Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, and product liability	86,151	71.1 %	85,972	72.7 %
LIFO expense	530	0.4 %	464	0.4 %
Overhead rate adjustments to inventory	72	0.1 %	(1,132)	(0.9)%
Labor rate adjustments to inventory	(46)	—	(71)	(0.1)%
Product liability	566	0.5 %	(97)	(0.1)%
Total cost of products sold	87,273	72.1 %	85,136	72.0 %
Gross profit	$33,848	27.9 %	$33,094	28.0 %

Note: For a discussion of the captions in the above table, please see the “Cost of Products Sold and Gross Profit” discussion above.

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Results of Operations - 2017

Year ended December 31, 2017, as compared to year ended December 31, 2016:

Annual Summary Unit Data

Firearms unit data for orders, production, shipments and ending inventory, and castings setups (a measure of foundry production) are as follows:

	2017	2016	2015
Units Ordered	1,298,800	2,246,600	1,517,000
Units Produced	1,610,900	2,125,500	1,721,300
Units Shipped	1,665,300	2,055,500	1,738,100
Average Sales Price	$311	$320	$313
Units – Backlog	254,900	621,400	430,300
Units – Company Inventory	102,900	157,400	87,400
Units – Distributor Inventory (1)	321,300	319,300	271,000
Castings Setups	91,715	170,681	164,212

Orders Received and Ending Backlog

(in millions except average sales price, net of Federal Excise Tax):

	2017	2016	2015
Orders Received	$386.2	$688.5	$463.2

Average Sales Price of Orders Received (2)	$297	$306	$303
Ending Backlog (2)	$75.4	$195.0	$137.8
Average Sales Price of Ending Backlog (2)	$296	$314	$320

(1) Distributor ending inventory as provided by the independent distributors of the Company's products.

(2) Average sales price for orders received and ending backlog is net of Federal Excise Tax of 10% for handguns and 11% for long guns.

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Product Demand

The estimated sell-through of the Company's products from the independent distributors to retailers decreased 17% in 2017 from 2016. For the same period, the National Instant Criminal Background Check System ("NICS") background checks (as adjusted by the National Shooting Sports Foundation ("NSSF")) decreased 11%. The decrease in estimated sell-through of the Company's products from the independent distributors to retailers is attributable to:

- Decreased overall consumer demand in 2017 due to stronger-than-normal demand during most of 2016, likely bolstered by the political campaigns for the November 2016 elections,
- Reduced purchasing by retailers in an effort to reduce their inventories and generate cash,
- Aggressive price discounting and lucrative consumer rebates offered by many of our competitors, and
- Excess industry manufacturing capacity, which exacerbated the above factors.

New products represented $137.8 million or 27% of firearms sales in 2017, compared to $192.6 million or 29% of firearms sales in 2016. New product sales include only major new products that were introduced in the past two years. In 2017, new products included the Precision Rifle, the Mark IV pistols, the LCP II pistol, and the American pistol. In December 2017, the Company introduced the Pistol Caliber Carbine, the Security 9 pistol, and the EC9s pistol. Due to the timing of these launches, they had only a minimal impact on the 2017 financial results.

Estimated sell-through from distributors to retailers and total adjusted NICS background checks:

	2017	2016	2015
Estimated Units Sold from Distributors to Retailers (1)	1,663,100	2,007,200	1,793,800
Total Adjusted NICS Background Checks (2)	13,967,800	15,727,700	14,244,200

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

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

(2)

NICS background checks are performed when the ownership of most firearms, either new or used, is transferred by a Federal Firearms Licensee. NICS

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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 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.

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 and manage increases in inventory. These reviews resulted in a decrease in total unit production of 24% in 2017 compared to 2016.

Inventories

The Company's finished goods inventory decreased by 54,500 units during 2017.

Distributor inventories of the Company's products increased by 2,000 units during 2017 and approximate a reasonable level to support rapid fulfillment of retailer demand.

Inventory data follows:

	December 31,		
	2017	2016	2015
Units – Company Inventory	102,900	157,400	87,400
Units – Distributor Inventory (3)	321,300	319,300	271,000
Total inventory (4)	424,200	476,700	358,400

(3) Distributor ending inventory as provided by the independent distributors of the Company's products. These numbers do not include goods-in-transit inventory that has been shipped from the Company but not yet received by the distributors.

(4) This total does not include inventory at retailers. The Company does not have access to data on retailer inventories.

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Quarterly Summary Unit Data

To supplement the summary annual unit data and discussion above, the same data for the last eight quarters follows:

	2017 Q4	Q3	Q2	Q1
Units Ordered	467,500	221,900	214,400	395,000
Units Produced	320,800	327,300	432,900	529,900
Units Shipped	383,200	329,100	432,000	521,000
Estimated Units Sold from Distributors to Retailers	425,600	341,300	362,400	533,800
Total Adjusted NICS Background Checks	4,210,000	2,948,000	3,116,000	3,694,000
Average Unit Sales Price	$306	$315	$302	$319
Units – Backlog	254,900	170,600	277,800	495,400
Units – Company Inventory	102,900	165,400	167,200	166,200
Units – Distributor Inventory (5)	321,300	363,800	376,000	306,400

	2016 Q4	Q3	Q2	Q1
Units Ordered	432,100	445,700	399,400	969,400
Units Produced	566,200	527,600	529,600	502,100
Units Shipped	527,300	507,500	504,000	516,700
Estimated Units Sold from Distributors to Retailers	529,100	453,400	453,700	571,000
Total Adjusted NICS Background Checks	4,861,000	3,519,000	3,199,000	4,148,000

Average Unit Sales Price	$304	$315	$330	$332
Units – Backlog	621,400	716,600	778,400	883,000
Units – Company Inventory	157,400	118,500	98,500	72,800
Units – Distributor Inventory (5)	319,300	321,100	267,000	216,700

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(5) Distributor ending inventory as provided by the independent distributors of the Company's products.

(in millions except average sales price, net of Federal Excise Tax)

	2017			
	Q4	Q3	Q2	Q1
Orders Received	$129.0	$62.9	$62.4	$131.9
Average Sales Price of Orders Received	$276	$283	$291	$334
Ending Backlog	$75.4	$56.6	$95.0	$163.8
Average Sales Price of Ending Backlog	$296	$332	$342	$331

	2016			
	Q4	Q3	Q2	Q1
Orders Received	$130.2	$116.5	$145.7	$296.1
Average Sales Price of Orders Received	$301	$261	$365	$305
Ending Backlog	$195.0	$219.1	$257.6	$276.1
Average Sales Price of Ending Backlog	$314	$306	$331	$313

Net Sales

Consolidated net sales were $522.3 million in 2017. This represents a decrease of $142.0 million or 21.4% from 2016 consolidated net sales of $664.3 million.

Firearms segment net sales were $517.7 million in 2017. This represents a decrease of $140.7 million or 21.4% from 2016 firearms net sales of $658.4 million. Firearms unit shipments decreased 19.0% in 2017.

Casting segment net sales were $4.6 million in 2017. This represents a decrease of $1.3 million or 22.7% from 2016 casting sales of $5.9 million.

Cost of Products Sold and Gross Profit

Consolidated cost of products sold was $368.2 million in 2017. This represents a decrease of $76.6 million or 17.2% from 2016 consolidated cost of products sold of $444.8 million.

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The gross margin was 29.5% in 2017. This represents a decrease from 33.0% in 2016 as illustrated below:

(in thousands)

Year Ended December 31,	2017		2016	
Net sales	$522,256	100.0%	$664,328	100.0%
Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall	367,551	70.4 %	441,773	66.5 %
LIFO expense	2,639	0.5 %	481	0.1 %
Overhead rate adjustments to inventory	(4,423)	(0.9)%	482	0.1 %
Labor rate adjustments to inventory	(379)	(0.1)%	(17)	—
Product liability	360	0.1 %	2,055	0.3 %
Product recall	2,500	0.5 %	—	—
Total cost of products sold	368,248	70.5 %	444,774	67.0 %
Gross profit	$154,008	29.5 %	$219,554	33.0 %

Cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability, and product recall- In 2017, cost of products sold, before LIFO, overhead and labor rate adjustments to inventory, product liability increased 3.9% as a percentage of sales compared to 2016. This decreased profitability is attributable to the decrease in sales which resulted in unfavorable de-leveraging of fixed manufacturing costs, including depreciation and indirect labor.

LIFO- Gross inventories decreased by $11.8 million in 2017 and increased $18.1 million in 2016. In 2017 and 2016, the Company recognized LIFO expense of $2.6 million and $0.5 million, respectively, which increased cost of products sold.

Overhead Rate Change- The net impact on inventory in 2017 and 2016 from the change in the overhead rates used to absorb overhead expenses into inventory was an increase of $4.4 million and a decrease of $0.5 million, respectively, reflecting decreased overhead efficiency in 2017 and increased overhead efficiency in 2016. The increase in inventory value in 2017 resulted in a corresponding decrease to cost of products sold and the decrease in inventory value in 2016 resulted in a corresponding increase to cost of products sold.

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Labor Rate Adjustments- In 2017, the change in inventory value resulting from the change in the labor rates used to absorb labor expenses into inventory was an increase of $0.4 million, reflecting decreased labor efficiency. This increase in inventory value resulted in a corresponding decrease to cost of products sold. In 2016, the change in inventory value resulting from the change in the labor rates used to absorb labor expenses into inventory was de minimis.

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. These costs totaled $0.4 million and $2.1 million in 2017 and 2016, respectively. See Note 18 in the notes to the financial statements "Contingent Liabilities" for further discussion of the Company's product liability.

Product Recall – In June 2017, the Company discovered that Mark IV pistols manufactured prior to June 1, 2017 had the potential to discharge unintentionally if the safety was not utilized correctly. The Company recalled all Mark IV pistols and recorded a $2.5 million expense in the second quarter, which is the expected total cost of the recall. No such expense was recorded in the prior year.

Gross Profit- Gross profit was $154.0 million or 29.5% of sales in 2017. This is a decrease of $65.6 million from 2016 gross profit of $219.6 million or 33.0% of sales in 2016.

Selling, General and Administrative

Selling, general and administrative expenses were $77.6 million in 2017, a decrease of $7.5 million from $85.1 million in 2016, and an increase from 12.8% of sales in 2016 to 14.9% of sales in 2017. The decrease is primarily attributable to the absence of the "2.5 Million Gun Challenge" and the "Ruger $5 Million Match Challenge", both of which were in effect in 2016. The decrease was partially offset by increased firearms promotional activities in 2017.

Other Operating Income, net

Other operating income, net was de minimis in 2017 and 2016.

Operating Income

Operating income was $76.3 million or 14.6% of sales in 2017. This is a decrease of $58.1 million from 2016 operating income of $134.4 million or 20.2% of sales.

Royalty Income

Royalty income was $0.5 million in 2017 and $1.1 million in 2016.

Interest Income and Interest Expense

Interest income and interest expense were negligible in 2017 and 2016.

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Other Income, Net

Other income, net was $0.9 million in 2017, an increase of $0.4 million from income of $0.5 million in 2016.

Income Taxes and Net Income

The effective income tax rate was 32.8% in 2017 and 35.6% in 2016. The decrease in the effective tax rate in 2017 is primarily attributable to:

- the inclusion of the tax impact of 2017 equity-based compensation in income taxes, as required by newly issued Accounting Standards Update (ASU) 2016-09, "Improvements to Employee Share Based Payment Accounting", which reduced the effective tax rate by 0.9%. In the prior year, the tax impact of equity-based compensation was recorded directly into equity, and
- The revaluation of the Company's net deferred tax liability at December 31, 2017 to reflect the impact of the lower statutory corporate tax rate enacted by the "Tax Cuts and Jobs Act", which reduced the effective tax rate by 0.7%.

The effective tax rate is expected to decrease to 24.5% in 2018 principally due to the "2017 Tax Cuts and Jobs Act" which reduces the Federal corporate income tax rate to 21% beginning in 2018.

As a result of the foregoing factors, consolidated net income was $52.1 million in 2017. This represents a decrease of $35.4 million from 2016 consolidated net income of $87.5 million.

Non-GAAP Financial Measure

In an effort to provide investors with additional information regarding its 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 measure may not be comparable to similarly titled measures being disclosed by other companies. In addition, the Company believes that the non-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.

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Non-GAAP Reconciliation – EBITDA

EBITDA

(Unaudited, dollars in thousands)

Year ended December 31,	2017	2016
Net income	$52,142	$87,472
Income tax expense	25,504	48,449
Depreciation and amortization expense	34,264	35,355
Interest expense	152	186
Interest income	(27)	(14)
EBITDA	$112,035	$171,448

EBITDA is defined as earnings before interest, taxes, and depreciation and amortization. The Company calculates this 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 to arrive at EBITDA. The Company's EBITDA calculation also excludes any one-time non-cash, non-operating expense.

Financial Condition

Liquidity

At December 31, 2018, the Company had cash and cash equivalents of $38.5 million and $114.3 million in short term investments. Our pre-LIFO working capital of $207.4 million, less the LIFO reserve of $46.3 million, resulted in working capital of $161.1 million and a current ratio of 3.3 to 1.

Operations

Cash provided by operating activities was $119.8 million, $101.2 million, and $104.8 million in 2018, 2017, and 2016, respectively. The increase in cash provided in 2018 compared to 2017 is attributable to significant decreases in accounts payable and accrued expenses in 2017 compared to modest increases in 2018, partially offset by other working capital fluctuations.

The decrease in cash provided in 2017 compared to 2016 is attributable to decreased profitability, partially offset by a decrease in inventories in 2017 and an increase in inventories in 2016 and other working capital fluctuations.

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

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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 were $10.5 million, $33.6 million, and $35.2 million in 2018, 2017, and 2016, respectively. In 2019, the Company expects capital expenditures to approximate $25 million, much of which will relate to tooling and fixtures for new product introductions and to upgrade and modernize manufacturing equipment. Due to market conditions and business circumstances, actual capital expenditures could vary significantly from the budgeted amount. The Company finances, and intends to continue to finance, all of these activities with funds provided by operations and current cash.

In 2018, the Company purchased $114.2 million of United States Treasury instruments which mature within one year.

In 2017, the Company repurchased 1,319,708 shares of its common stock for $64.8 million in the open market. The average price per share purchased was $49.14. These purchases were funded with cash on hand. In 2016, the Company repurchased 283,343 shares of its common stock for $14.0 million in the open market. The average price per share purchased was $49.43. These purchases were funded with cash on hand. No shares were repurchased in 2018.

At December 31, 2018, $88.7 million remained authorized for future share repurchases.

The Company paid dividends totaling $19.2 million, $23.9 million, and $32.8 million in 2018, 2017, and 2016, respectively. The dividend varies every quarter because the Company pays a percentage of earnings rather than a fixed amount per share. The Company's practice is to pay a dividend of approximately 40% of net income.

On February 15, 2019, the Company's Board of Directors authorized a dividend of 28¢ per share to shareholders of record on March 15, 2019. The payment of future dividends depends on many factors, including internal estimates of future performance, then-current cash, and the Company's need for funds.

The Company provides supplemental discretionary contributions to substantially all employees' individual 401(k) accounts.

Based on its unencumbered assets, the Company believes it has the ability to raise cash through issuance of short-term or long-term debt. The Company's unsecured $40 million credit facility, which expires on August 31, 2019, remained unused at December 31, 2018 and the Company has no debt.

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Contractual Obligations

The table below summarizes the Company's significant contractual obligations at December 31, 2018, and the effect such obligations are expected to have on the Company's liquidity and cash flows in future periods. This table excludes amounts already recorded on the Company's balance sheet as current liabilities at December 31, 2018.

"Purchase Obligations" as used in the below table includes all agreements to purchase goods or services that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Certain of the Company's purchase orders or contracts for the purchase of raw materials and other goods and services that may not necessarily be enforceable or legally binding on the Company are also included in "Purchase Obligations" in the table, and, therefore, certain of the Company's purchase orders or contracts included in the table may represent authorizations to purchase rather than legally binding agreements. The Company expects to fund all of these commitments with cash flows from operations and current cash.

Payment due by period (in thousands)

Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 Years**
Long-Term Debt Obligations	—	—	—	—	—
Capital Lease Obligations	—	—	—	—	—
Operating Lease Obligations	$4,929	$1,032	$1,707	$430	$1,760
Purchase Obligations	$26,716	$26,716	—	—	—
Other Long Term Liabilities Reflected on the Registrant's Balance sheet Under GAAP	—	—	—	—	—
Total	$31,645	$27,748	$1,707	$430	$1,760

The expected timing of payment of the obligations discussed above is estimated based on current information. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations.

Firearms Legislation and Litigation

See Item 1A - Risk Factors and Note 18 to the financial statements which are included in the Annual Report on Form 10-K for a discussion of firearms legislation and litigation.

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.

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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. If these regulations become more stringent in the future and we are not able to comply with them, such noncompliance could have a material adverse impact on 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.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make assumptions and estimates that affect the reported amounts of assets and liabilities as of the balance sheet date and net sales and expenses recognized and incurred during the reporting period then ended. The Company bases estimates on prior experience, facts and circumstances, and other assumptions, including those reviewed with actuarial consultants and independent counsel, when applicable, that are believed to be reasonable. However, actual results may differ from these estimates.

The Company believes the determination of its product liability accrual is a critical accounting policy. The Company's management reviews every lawsuit and claim and is in contact with independent and corporate counsel on an ongoing basis. The provision for product liability claims is based upon many factors, which vary for each case. These factors include the type of claim, nature and extent of injuries, historical settlement ranges, jurisdiction where filed, and advice of counsel. An accrual is established for each lawsuit and claim, when appropriate, based on the nature of each such lawsuit or claim.

Amounts are charged to product liability expense in the period in which the Company becomes aware that a claim or, in some instances a threat of a claim, has been made when potential losses or costs of defense are probable and can be reasonably estimated. Such amounts are determined based on the Company's experience in defending similar claims. Occasionally, charges are made for claims made in prior periods because the cumulative actual costs incurred for that claim, or reasonably expected to be incurred in the future, exceed amounts already provided with respect to such claims. Likewise, credits may be taken if cumulative actual costs incurred for that claim, or reasonably expected to be incurred in the future, are less than amounts previously provided.

While it is not possible to forecast the outcome of litigation or the timing of related costs, in the opinion of management, after consultation with independent and corporate counsel, there is a remote likelihood that litigation, including punitive damage claims, will have a material adverse effect on the financial position of the Company, but such litigation may have a material impact on the Company's financial results and cash flows for a particular period.

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The Company believes the valuation of its inventory and the related excess and obsolescence reserve is also a critical accounting policy. Inventories are carried at the lower of cost, principally determined by the last-in, first-out (LIFO) method, or market. An actual valuation of inventory under the LIFO method is made at the end of each year based on the inventory levels and prevailing inventory costs existing at that time.

The Company determines its excess and obsolescence reserve by projecting the year in which inventory will be consumed into a finished product. Given ever-changing market conditions, customer preferences and the anticipated introduction of new products, it does not seem prudent nor supportable to carry inventory at full cost beyond that needed during the next 36 months.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers Topic 606, (“ASC 606”), which supersedes nearly all existing revenue recognition guidance. As more fully discussed in Note 2, the Company adopted ASC 606 using the modified retrospective method on January 1, 2018.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718). The most significant change in the new compensation guidance is that all excess tax benefits and tax deficiencies (including tax benefits of dividends) on share-based compensation awards should be recognized in the Statement of Income as income tax expense. Previously such benefits or deficiencies were recognized in the Balance Sheet as adjustments to additional paid-in capital. The new guidance was effective in fiscal years beginning after December 15, 2016 and interim periods thereafter. The Company adopted ASU 2016-09 in the first quarter of 2017. The impact of adopting this change in accounting principle reduced the Company’s effective tax rate by 2% for the period ending December 31, 2017 and did not impact the effective tax rate for the period ended December 31, 2018. The adoption of this pronouncement did not have a material impact on the Company’s results of operations or financial position in either year.

In February 2016, the FASB issued ASU 2016-02, Leases Topic 842 (“ASC 842”), which amends the existing accounting standards for leases. ASC 842 requires lessees to record a right-of-use asset and a corresponding lease liability on the balance sheet for all leases (with the exception of short-term leases) and disclose key information about leasing arrangements, whereas under current standards, the Company’s operating leases are not recognized on its consolidated balance sheet. Leases will be classified as finance or operating, with classification affecting the pattern and classification of expense recognition in the income statement. Topic 842 was subsequently amended by ASU No. 2018-01, Land Easement Practical Expedient for Transition to Topic 842; ASU No. 2018-10, Codification Improvements to Topic 842, Leases; and ASU No. 2018-11, Targeted Improvements. ASC 842 is effective for years beginning after December 15, 2018, including interim periods within those fiscal years, and is to be applied using either a modified retrospective approach, or an optional transition method which allows an entity to apply the new standard at the adoption date with a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company expects to adopt ASC 842 in the first quarter of 2019 using this optional transition method. The new standard also

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provides practical expedients for an entity's ongoing accounting. The Company currently expects to elect the short-term lease recognition exemption for all leases that qualify. The Company also expects to elect the practical expedient to not separate lease and non-lease components for all of its leases. The Company is finalizing its implementation related to policies, processes and internal controls to comply with the guidance. The Company estimates that the right-of-use assets and lease liabilities for the lease portfolio to be recorded on its consolidated balance sheet, as of January 1, 2019 will be less than $5 million, primarily related to real estate. The adoption of this pronouncement is not expected to impact the Company's consolidated statements of operations or its consolidated statement of cash flows.

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. Words such as "expect," "believe," "anticipate," "intend," "estimate," "will," "should," "could" and other words and terms of similar meaning, typically identify such forward-looking statements. 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 7A— 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 100 basis point change in market interest rates over the next year would not materially impact the Company's earnings or cash flows. A hypothetical 100 basis point change in market interest rates would not have a material effect on the fair value of the Company's investments.

ITEM 8—FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Sturm, Ruger & Company, Inc. and Subsidiary

Opinion on the Internal Control Over Financial Reporting

We have audited Sturm, Ruger & Company, Inc. and Subsidiary's (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, and the related consolidated statements of comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and our report dated February 20, 2019 expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/RSM US LLP

Stamford, Connecticut

February 20, 2019

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of Sturm, Ruger & Company, Inc. and Subsidiary

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Sturm, Ruger & Company, Inc. and Subsidiary (the Company) as of December 31, 2018 and 2017, and the related consolidated statements of income and comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes and schedule (collectively, the financial statements). In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated February 20, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/RSM US LLP

We have served as the Company's auditor since 2005.

Stamford, Connecticut

February 20, 2019

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Consolidated Balance Sheets

(Dollars in thousands, except per share data)

December 31,	2018	2017
Assets		
Current Assets		
Cash and cash equivalents	$38,492	$63,487
Short-term investments	114,326	—
Trade receivables, net	45,031	60,082
Gross inventories	80,288	87,592
Less LIFO reserve	(46,341)	(45,180)
Less excess and obsolescence reserve	(2,527)	(2,698)
Net inventories	31,420	39,714
Prepaid expenses and other current assets	2,920	3,501
Total Current Assets	232,189	166,784
Property, Plant, and Equipment	358,756	365,013
Less allowances for depreciation	(276,045)	(261,218)
Net property, plant and equipment	82,711	103,795
Deferred income taxes	2,969	—
Other assets	17,663	13,739
Total Assets	$335,532	$284,318

See accompanying notes to consolidated financial statements.

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December 31,	2018	2017
Liabilities and Stockholders' Equity		
Current Liabilities		
Trade accounts payable and accrued expenses	$33,021	$32,422
Contract liabilities with customers (Note 2)	7,477	—
Product liability	1,073	729
Employee compensation and benefits	20,729	14,315
Workers' compensation	5,551	5,211
Income taxes payable	3,340	—
Total Current Liabilities	71,191	52,677
Product liability	99	90
Deferred income taxes	—	1,402
Contingent liabilities (Note 18)	—	—
Stockholders' Equity		
Common stock, non-voting, par value $1:		
Authorized shares – 50,000; none issued		
Common stock, par value $1:		
Authorized shares – 40,000,000		
2018 – 24,123,418 issued, 17,458,020 outstanding	24,123	24,092
2017 – 24,092,488 issued, 17,427,090 outstanding		
Additional paid-in capital	33,291	28,329
Retained earnings	350,423	321,323
Less: Treasury stock – at cost		
2018 – 6,665,398 shares	(143,595)	(143,595)
2017 – 6,665,398 shares		
Total Stockholders' Equity	264,242	230,149
Total Liabilities and Stockholders' Equity	$335,532	$284,318

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Income and Comprehensive Income

(In thousands, except per share data)

Year ended December 31,	2018	2017	2016
Net firearms sales	$490,607	$517,701	$658,433
Net castings sales	5,028	4,555	5,895
Total net sales	495,635	522,256	664,328
Cost of products sold	361,277	368,248	444,774
Gross profit	134,358	154,008	219,554
Operating Expenses:			
Selling	35,111	49,232	56,146
General and administrative	32,248	28,396	29,004
Other operating (expense) income, net	(10)	31	(5)
Total operating expenses	67,349	77,659	85,145
Operating income	67,009	76,349	134,409
Other income:			
Royalty income	804	506	1,142
Interest income	211	27	14
Interest expense	(330)	(152)	(186)
Other income, net	1,020	916	542
Total other income, net	1,705	1,297	1,512
Income before income taxes	68,714	77,646	135,921
Income taxes	17,781	25,504	48,449
Net income and comprehensive income	$50,933	$52,142	$87,472
Basic Earnings Per Share	$2.92	$2.94	$4.62
Diluted Earnings Per Share	$2.88	$2.91	$4.59
Cash Dividends Per Share	$1.10	$1.36	$1.73

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Stockholders' Equity

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Treasury Stock	Total
Balance at December 31, 2015	23,776	29,591	239,098	(64,727)	227,738
Net income			87,472		87,472
Dividends paid			(32,815)		(32,815)
Stock-based compensation		3,054			3,054
Exercise of stock options and vesting of RSU's		(14,002)			(14,002)
Tax benefit realized from exercise of stock options and vesting of RSU's		8,826			8,826
Common stock issued – compensation plans	258	(258)			—
Unpaid dividends accrued			(355)		(355)
Repurchase of 283,343 shares of common stock				(14,018)	(14,018)
Balance at December 31, 2016	24,034	27,211	293,400	(78,745)	$265,900
Net income			52,142		52,142
Dividends paid			(23,905)		(23,905)
Stock-based compensation		3,659			3,659
Exercise of stock options and vesting of RSU's		(2,483)			(2,483)
Common stock issued – compensation plans	58	(58)			—
Unpaid dividends accrued			(314)		(314)
Repurchase of 1,319,708 shares of common stock				(64,850)	(64,850)
Balance at December 31, 2017	24,092	28,329	321,323	(143,595)	230,149
Net income			50,933		50,933
Dividends paid			(19,201)		(19,201)
Stock-based compensation		5,809			5,809
Vesting of RSU's		(816)			(816)
Common stock issued – compensation plans	31	(31)			—
Unpaid dividends accrued			(405)		(405)
Adoption of ASC 606 (Note 2)			(2,227)		(2,227)
Balance at December 31, 2018	$ 24,123	$ 33,291	$350,423	$(143,595)	$264,242

See accompanying notes to consolidated financial statements.

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Consolidated Statements of Cash Flows

(In thousands)

Year ended December 31,	2018	2017	2016
Operating Activities			
Net income	$50,933	$52,142	$87,472
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	31,972	34,264	35,355
Stock-based compensation	5,809	3,659	3,054
Excess and obsolescence inventory reserve	(185)	358	522
Loss (gain) on sale of assets	(10)	31	59
Deferred income taxes	(4,371)	1,736	1,836
Changes in operating assets and liabilities:			
Trade receivables	15,051	9,360	2,279
Inventories	8,479	14,463	(17,958)
Trade accounts payable and accrued expenses	939	(16,060)	5,602
Contract liability to customers	5,250	—	—
Employee compensation and benefits	6,009	(11,466)	(3,186)
Product liability	353	(1,000)	1,075
Prepaid expenses, other assets and other liabilities	(3,757)	13,704	(6,348)
Income taxes payable	3,340	—	(4,962)
Cash provided by operating activities	119,812	101,191	104,800
Investing Activities			
Property, plant, and equipment additions	(10,541)	(33,596)	(35,215)
Purchases of short-term investments	(114,259)	—	—
Net proceeds from sale of assets	10	3	325
Cash used for investing activities	(124,790)	(33,593)	(34,890)
Financing Activities			
Dividends paid	(19,201)	(23,905)	(32,815)
Tax benefit from share-based compensation	—	—	8,825
Repurchase of common stock	—	(64,850)	(14,018)
Payment of employee withholding tax related to share-based compensation	(816)	(2,482)	(14,001)
Cash used for financing activities	(20,017)	(91,237)	(52,009)
(Decrease) increase in cash and cash equivalents	(24,995)	(23,639)	17,901
Cash and cash equivalents at beginning of year	63,487	87,126	69,225
Cash and cash equivalents at end of year	$38,492	$63,487	$87,126

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

(Dollars in thousands, except per share)

1. Summary of 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 were from firearms. Export sales represented approximately 4% of firearms 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 and metal injection molding (“MIM”) parts for internal use in its firearms and utilizes available capacity to manufacture and sell investment castings and MIM parts to unaffiliated, third-party customers. Castings were approximately 1% of the Company’s total sales for the year ended December 31, 2018.

Preparation of Financial Statements

The Company follows United States generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

The significant accounting policies described below, together with the notes that follow, are an integral part of the Financial Statements.

Principles of Consolidation

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

Revenue Recognition

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

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customers are entitled to receive no charge products based on their purchases of certain of the Company's products from the independent distributors. The fulfillment of these no charge products is the Company's responsibility. In such instances, the Company allocates the revenue of the promotional sales based on the estimated level of participation in the sales promotional program and the timing of the shipment of all of the firearms included in the promotional program, including the no charge firearms. Revenue is recognized proportionally as each performance obligation is satisfied, based on the relative customary price of each product. Customary prices are generally determined based on the prices charged to the independent distributors. The net change in contract liabilities for a given period is reported as an increase or decrease to sales. The Company accounts for cash sales discounts as a reduction in sales. Amounts billed to customers for shipping and handling fees are included in net sales and costs incurred by the Company for the delivery of goods are classified as selling expenses. Federal excise taxes are excluded from net sales.

Cash and Cash Equivalents

The Company considers interest-bearing deposits with financial institutions with remaining maturities of three months or less at the time of acquisition to be cash equivalents.

Fair Value Measurements of Short-term Investments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal or most advantageous market at the measurement date. Fair value is established according to a hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels, which are described below:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. Level 3 inputs are given the lowest priority in the fair value hierarchy.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

As of December 31, 2018, all of the Company’s short-term investments are U.S. Treasury instruments (Level 1), maturing within one year. Such securities are classified as held to maturity, since the Company has the intent and ability to do so, and are carried at cost plus accrued interest, which approximates fair value.

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Accounts Receivable

The Company establishes an allowance for doubtful accounts based on the creditworthiness of its customers and historical experience. While the Company uses the best information available to make its evaluation, future adjustments to the allowance for doubtful accounts may be necessary if there are significant changes in economic and industry conditions or any other factors considered in the Company's evaluation. Bad debt expense has been immaterial during each of the last three years.

Inventories

Substantially all of the Company's inventories are valued at the lower of cost, principally determined by the last-in, first-out (LIFO) method, or market. Elements of cost in inventories include raw materials, direct labor and manufacturing overhead.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost. Depreciation is computed over useful lives using the straight-line and declining balance methods predominately over 15 years for buildings, 7 years for machinery and equipment and 3 years for tools and dies. When assets are retired, sold or otherwise disposed of, their gross carrying values and related accumulated depreciation are removed from the accounts and a gain or loss on such disposals is recognized when appropriate.

Maintenance and repairs are charged to operations; replacements and improvements are capitalized.

Long-lived Assets