STURM RUGER & CO INC
Form 10-Q
October 24, 2007

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**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended September 30, 2007**

**OR**

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

**For the transition period from __________ to __________**

**Commission file number 1-10435**

**STURM, RUGER & COMPANY, INC.**

(Exact name of registrant as specified in its charter)

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

(203) 259-7843

(Registrant s telephone number, including area code)

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

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 o Accelerated filer þ Non-accelerated filer o

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

The number of shares outstanding of the issuer s common stock as of September 30, 2007: Common Stock, $1 par value 22,798,732.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)
STURM, RUGER & COMPANY, INC.
CONDENSED BALANCE SHEETS
(Dollars in thousands, except share data)

| | September 30, 2007 | December 31, 2006 (Note) |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Cash and cash equivalents | $ 2,706 | $ 7,316 |
| Short-term investments | 60,857 | 22,026 |
| Trade receivables, net | 15,066 | 18,007 |
| Gross inventories | 60,469 | 87,477 |
| Less LIFO reserve | (45,106) | (57,555) |
| Less excess and obsolescence reserve | (3,882) | (5,516) |
| Net inventories | 11,481 | 24,406 |
| Deferred income taxes | 5,903 | 8,347 |
| Prepaid expenses and other current assets | 1,666 | 1,683 |
| Total current assets | 97,679 | 81,785 |
| Property, plant and equipment | 125,266 | 128,042 |
| Less allowances for depreciation | (103,248) | (105,081) |
| Net property, plant and equipment | 22,018 | 22,961 |
| Deferred income taxes | 1,369 | 3,630 |
| Other assets | 4,101 | 8,690 |
| Total Assets | $ 125,167 | $ 117,066 |

*See notes to condensed financial statements.*

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)
STURM, RUGER & COMPANY, INC.
CONDENSED BALANCE SHEETS
(Dollars in thousands, except share data)

| | September 30, 2007 | December 31, 2006 (Note) |
|---|---|---|
| **Liabilities and Stockholders Equity** | | |
| Current Liabilities | | |
| Trade accounts payable and accrued expenses | $ 4,912 | $ 6,342 |
| Product liability | 1,249 | 904 |
| Employee compensation and benefits | 4,847 | 6,416 |
| Workers compensation | 6,000 | 6,547 |
| Income taxes payable | 858 | 1,054 |
| Total current liabilities | 17,866 | 21,263 |
| Accrued pension liability | 5,798 | 7,640 |
| Product liability accrual | 774 | 837 |
| Contingent liabilities Note 8 | | |
| 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; issued and outstanding 22,798,732 and 22,638,700 | 22,799 | 22,639 |
| Additional paid-in capital | 1,626 | 2,615 |
| Retained earnings | 87,079 | 74,505 |
| Accumulated other comprehensive loss | (10,775) | (12,433) |
| Total Stockholders Equity | 100,729 | 87,326 |
| Total Liabilities and Stockholders Equity | $125,167 | $117,066 |

Note:
The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.
*See notes to condensed financial statements.*

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STURM, RUGER & COMPANY, INC.
CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)
(Dollars in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net firearms sales | $ 29,298 | $ 34,378 | $ 112,535 | $ 104,425 |
| Net castings sales | 2,565 | 7,234 | 9,892 | 19,890 |
| Total net sales | 31,863 | 41,612 | 122,427 | 124,315 |
| Cost of products sold | 26,268 | 35,413 | 88,140 | 99,588 |
| Gross profit | 5,595 | 6,199 | 34,287 | 24,727 |
| Expenses: | | | | |
| Selling | 3,853 | 3,275 | 10,747 | 11,110 |
| General and administrative | 2,675 | 2,587 | 10,510 | 9,206 |
| Pension plan curtailment charge | 1,143 | | 1,143 | |
| Impairment of assets | 489 | | 489 | |
| | 8,160 | 5,862 | 22,889 | 20,316 |
| Operating profit (loss) | (2,565) | 337 | 11,398 | 4,411 |
| Gain on sale of non-manufacturing assets (Notes 9 and 11) | | | 7,085 | |
| Other income-net | 823 | 1,261 | 1,798 | 1,974 |
| Total other income | 823 | 1,261 | 8,883 | 1,974 |
| Income (loss) before income taxes | (1,742) | 1,598 | 20,281 | 6,385 |
| Income taxes (benefit) | (1,125) | 641 | 7,707 | 2,560 |
| Net income (loss) | ($ 617) | $ 957 | $ 12,574 | $ 3,825 |
| Earnings (loss) per share | | | | |
| Basic | ($ 0.03) | $ 0.04 | $ 0.55 | $ 0.14 |
| Diluted | ($ 0.03) | $ 0.04 | $ 0.55 | $ 0.14 |

| Average shares outstanding | | | | |
|---|---|---|---|---|
| Basic | 22,759 | 26,679 | 22,686 | 26,832 |
| Diluted | 22,759 | 26,684 | 23,030 | 26,835 |

*See notes to condensed financial statements.*

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STURM, RUGER & COMPANY, INC.
CONDENSED STATEMENT OF STOCKHOLDERS EQUITY (UNAUDITED)
(Dollars in thousands)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) | Total |
|---|---|---|---|---|---|
| Balance at December 31, 2006 | $22,639 | $ 2,615 | $74,505 | $(12,433) | $ 87,326 |
| Net income | | | 12,574 | | 12,574 |
| Impact of curtailment charge on pension liability | | | | 1,658 | 1,658 |
| Comprehensive income | | | | | 14,232 |
| Stock-based compensation, net of tax | | 297 | | | 297 |
| Stock options exercised | 160 | (1,286) | | | (1,126) |
| Balance at September 30, 2007 | $22,799 | $ 1,626 | $87,079 | $(10,775) | $100,729 |

*See notes to condensed financial statements.*

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STURM, RUGER & COMPANY, INC.
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2007 | 2006 |
| Operating Activities | | |
| Net income | $ 12,574 | $ 3,825 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation | 3,126 | 3,515 |
| Slow moving inventory valuation adjustment | (1,590) | |
| Asset impairment charge | 489 | |
| Pension plan curtailment charge | 1,143 | |
| Stock option expense | 297 | 64 |
| Gain on sale of assets | (7,141) | (998) |
| Deferred income taxes | 4,705 | 111 |
| Changes in operating assets and liabilities: | | |
| Trade receivables | 2,941 | (5,966) |
| Inventories | 14,515 | 8,146 |
| Trade accounts payable and other liabilities | (3,546) | 1,089 |
| Product liability | 282 | (339) |
| Prepaid expenses and other assets | (1,665) | 1,959 |
| Income taxes | (196) | (5) |
| Cash provided by operating activities | 25,934 | 11,401 |
| Investing Activities | | |
| Property, plant and equipment additions | (3,128) | (2,417) |
| Proceeds from the sale of assets | 12,542 | 1,829 |
| Purchases of short-term investments | (49,832) | (87,064) |
| Proceeds from maturities of short-term investments | 11,000 | 104,017 |
| Cash provided by (used for) investing activities | (29,418) | 16,365 |
| Financing Activities | | |
| Payments of employee witholding tax for cashless exercise of stock options | (1,126) | |
| Repurchase and retirement of common stock | | (25,205) |
| Cash (used for) financing activities | (1,126) | (25,205) |
| Increase (decrease) in cash and cash equivalents | (4,610) | 2,561 |
| Cash and cash equivalents at beginning of period | 7,316 | 4,057 |

| | | |
|---|---|---|
| Cash and cash equivalents at end of period | $ 2,706 | $ 6,618 |

*See notes to condensed financial statements.*

STURM, RUGER & COMPANY, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)
September 30, 2007

NOTE 1 BASIS OF PRESENTATION

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

In the opinion of management, the accompanying unaudited condensed financial statements include all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the results of the interim periods. Operating results for the nine months ended September 30, 2007 are not indicative of the results to be expected for the full year ending December 31, 2007. These financial statements have been prepared on a basis that is substantially consistent with the accounting principles applied in our Annual Report on Form 10-K for the year ended December 31, 2006.

NOTE 2 SIGNIFICANT ACCOUNTING POLICIES

Organization:

Sturm, Ruger & Company, Inc. (the Company ) is principally engaged in the design, manufacture, and sale of firearms and investment castings. The Company s design and manufacturing operations are located in the United States. Sales for the three months ended September 30, 2007 were 94% domestic and 6% export. Sales for the nine months ended September 30, 2007 were 95% domestic and 5% export. The Company s firearms are sold through a select number of independent wholesale distributors principally to the commercial sporting market. Investment castings are sold either directly or through manufacturers representatives to companies in a wide variety of industries.

Use of Estimates:

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

Reclassifications:

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

Recent Accounting Pronouncements:

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ( FAS 157 ) and No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* ( FAS 159 ). These Standards define fair value, establishes a framework for measuring fair value under generally

accepted accounting principles and expands disclosures about fair value measurements. FAS 157 and FAS 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of FAS 157 and FAS 159 are not expected to have a material impact on the Company s financial position, results of operations and cash flows.

NOTE 3 INVENTORIES

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

During the nine month period ended September 30, 2007, inventory quantities were reduced. This reduction in inventory levels is expected to continue through year-end. This reduction will result in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the current cost of purchases. Although the effect of such a liquidation cannot be precisely quantified at the present time, management believes that if a LIFO liquidation continues to occur in 2007, the impact may be material to the Company s results of operations for the period but will not have a material impact on the financial position of the Company. The Company estimates that the impact of this liquidation on the results of operations for the three and nine month periods ended September 30, 2007 was to reduce cost of products sold by $0.2 and $16.4 million, respectively.

Inventories consist of the following (in thousands):

| | | September 30, 2007 | | December 31, 2006 |
|---|---|---|---|---|
| Inventory at FIFO | | | | |
| Finished products | $ | 8,323 | $ | 13,117 |
| Materials and work in process | | 52,146 | | 74,360 |
| Gross inventory | | 60,469 | | 87,477 |
| Less: LIFO reserve | | (45,106) | | (57,555) |
| Less: excess and obsolescence reserve | | (3,882) | | (5,516) |
| Net inventories | $ | 11,481 | $ | 24,406 |

In addition to the aforementioned liquidation, the LIFO reserve was further reduced by $1.7 million as a result of the sale of excess titanium inventory in 2007. This sale did not have an impact on the statement of income.

The LIFO impact on FIFO inventory increased from 66% at December 31, 2006 to 76% at September 30, 2007. The excess and obsolescence reserve decreased primarily as a result of this increase.

NOTE 4 INCOME TAXES

The Company s 2007 effective tax rate differs from the statutory tax rate due principally to state income taxes partially offset by tax benefits related to the American Jobs Creation Act of 2004. The Company s 2006 effective tax rate differs from the statutory tax rate due principally to state income taxes. The effective income tax rates for the nine months ended September 30, 2007, is 38.0%. The Company s 2007 effective tax rate is lower than the 2006 effective tax rate of 40.1% principally as a result of increased benefit of Federal manufacturing income tax credits.

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

for years before 2003. In the third quarter of 2007, the Internal Revenue Service (IRS) completed an examination of the Company s Federal income tax return for 2005. The IRS did not propose any adjustments as a result of this examination and has accepted the Company s return as filed.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. Upon the adoption of FIN 48, the Company commenced a review of all open tax years in all jurisdictions. The Company does not believe it has included any uncertain tax positions in its Federal income tax return or any of the state income tax returns it is currently filing. The Company has made an evaluation of the potential impact of additional state taxes being assessed by jurisdictions in which the Company does not currently consider itself liable. The Company does not anticipate that such additional taxes, if any, would result in a material change to its financial position. However, the Company anticipates that it is more likely than not that additional state tax liabilities in the range of $0.5 to $1.0 million exist. The Company had previously recorded $0.7 million relating to these additional state income taxes, including approximately $0.2 million for the payment of interest and penalties. This amount is included in income taxes payable at September 30, 2007. In connection with the adoption of FIN 48, the Company will include interest and penalties related to uncertain tax positions as a component of its provision for taxes.

NOTE 5 PENSION PLANS

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

During the quarter ended September 30, 2007, the Company amended its hourly and salaried defined benefit pension plans so that employees will no longer accrue benefits under these plans effective December 31, 2007. This action, which will freeze the benefits for essentially all employees, will also prevent future hires from joining the plans, effective December 31, 2007. Starting in 2008, the Company will provide supplemental discretionary contributions to substantially all employees individual 401(k) accounts.

These amendments resulted in a $1.2 million pension curtailment charge that was recognized in the quarter ended September 30, 2007.

In 2008 and future years, the Company will likely be required to make cash contributions to the two defined benefit pension plans. The total amount of these future cash contributions will be dependent on the investment returns generated by the plans assets and the then applicable discount rates used to calculate the plans liabilities, and could be as high as $10 million in aggregate.

In future years, the total annual cash outlays for retirement benefits, which would include the continuing funding of the two defined benefit pension plans and the new supplemental discretionary 401(k) contributions, are expected to be comparable to the current retirement funding levels.

The Company anticipates terminating the two defined benefit pension plans in the future when they are more fully funded. When the plans are terminated, the Company will likely incur a plan termination charge. This charge, which would be as much as $15 million to $20 million if the plans were terminated today, will likely be much less when actually terminated. Notwithstanding the aforementioned termination charge, the Company s annual retirement benefit expense is not expected to increase materially in the foreseeable future.

The estimated cost of the defined benefit plans is summarized below (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | $ 339 | $ 406 | $ 1,090 | $ 1,216 |
| Interest cost | 700 | 821 | 2,249 | 2,463 |
| Expected return on plan assets | (861) | (993) | (2,765) | (2,980) |
| Amortization of prior service cost | 33 | 66 | 105 | 198 |
| Recognized actuarial gains | 253 | 256 | 812 | 768 |
| Net periodic pension cost | $ 464 | $ 556 | $ 1,491 | $ 1,665 |

The Company made contributions totaling $0.5 million and $1.4 million related to its defined benefit pension plans in the three and nine months ended September 30, 2007. The Company plans on contributing $5 million to its defined benefit pension plans in the fourth quarter of 2007.

NOTE 6 SHARE BASED PAYMENTS

On February 23, 2007 the Company adopted and on April 24, 2007 shareholders approved the Sturm, Ruger & Company, Inc. 2007 Stock Incentive Plan (the Plan ). The Plan replaces both the Company s 1998 Stock Incentive Plan and its 2001 Stock Option Plan for Non-Employee Directors and becomes the sole plan for providing stock-based incentive compensation. All directors (including non-employee directors), officers, employees and independent contractors of the Company are eligible to participate in the Plan. The Plan provides for the issuance of up to 2,550,000 shares of the Company s common stock over the ten-year term of the Plan.

The Plan provides for the granting of non-qualified stock options to purchase up to 2,350,000 shares of the Company s common stock at a price not less than 100% of the fair market value of the stock as of the date of the grant. Incentive stock options are only available to employee participants. Each non-employee director will be granted options to purchase 20,000 shares of stock upon becoming a director. Options are exercisable for a period of up to ten years. The Plan also provides for restricted stock awards available to all eligible participants. Each non-employee director will be granted an annual award of restricted stock equal to $25,000 on the date of grant. The Plan also provides for the granting of deferred stock awards and share appreciation rights to all eligible participants.

A summary of changes in options outstanding under the 1998 Stock Incentive Plan and 2001 Stock Option Plan for Non-Employee Directors is summarized below:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at December 31, 2006 | 1,325,000 | $ 9.46 |
| Granted | | |
| Exercised | 495,000 | 11.76 |
| Expired | 50,000 | 9.59 |
| Outstanding September 30, 2007 | 780,000 | $ 8.14 |

The aggregate intrinsic value (mean market price at September 30, 2007 less the weighted average exercise price) of options outstanding under the 1998 Stock Incentive Plan and 2001 Stock Option Plan for Non-Employee Directors was approximately $7.8 million.

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A summary of changes in options outstanding under the 2007 Stock Incentive Plan is summarized below:

| | Shares | Weighted Average Exercise Price |
|---|---|---|
| Outstanding at December 31, 2006 | | |
| Granted | 286,250 | $ 13.39 |
| Exercised | | |
| Expired | | |
| Outstanding September 30, 2007 | 286,250 | $ 13.39 |

The aggregate intrinsic value (mean market price at September 30, 2007 less the weighted average exercise price) of options outstanding under the 2007 Stock Incentive Plan was approximately $1.4 million.

The aggregate compensation expense for options granted in April 2007, calculated using the Black-Scholes option-pricing model, was $0.7 million. This expense, which is a non-cash item, is being amortized in the Company s Statements of Operations over the vesting period. 171,000 of the options granted to employees vest upon the Company s attainment of certain performance objectives if achieved within three years from the date of grant. 115,000 of the options granted to employees vest over five years. Compensation costs related to share-based payments granted under all three plans recognized in the Condensed Statements of Operations aggregated $0.1 million and $0.3 million for the three and nine months ended September 30, 2007, respectively. For the three and nine months ended September 30, 2006, compensation costs related to share-based payments recognized in the Condensed Statements of Operations were $34,000 and $64,000, respectively.

In addition to the above options granted in the nine month period ended September 30, 2007 under the 2007 Stock Incentive Plan, deferred stock awards totaling 29,945 shares with a fair value of $438,000 were granted to certain executives of the Company and restricted stock shares totaling 10,920 with a fair value of $150,000 were issued to non-employee directors of the Company in partial payment of directors fees. The deferred shares granted to employees vested thirty days from the date of grant. The restricted shares issued to non-employee directors vest on the date of the 2008 annual meeting of stockholders. As a result of granting these awards, the Company s income before taxes and net income for the nine months ended September 30, 2007 were $438,000 and $262,000 lower, respectively.

The Company has adopted a policy to pay 25% of all officers annual incentive compensation in deferred stock which vests over three years commencing on the date of the award. This policy commences with the 2007 fiscal year and any annual incentive compensation earned by officers for that period.

NOTE 7 BASIC AND DILUTED EARNINGS PER SHARE

Shares outstanding as of September 30, 2007 and 2006 were 22,798,732 and 26,910,720, respectively.

Diluted earnings per share reflect the impact of options outstanding using the treasury stock method, when applicable. This resulted in diluted weighted-average shares outstanding for the nine months ended September 30, 2007 of 23,030,164 shares. Since a loss was recorded for the three months ended September 30, 2007, there were no additional shares included in the total diluted shares outstanding for that period. Diluted weighted average of shares outstanding for both the three and nine months ended September 30, 2006 were 26,912,000.

NOTE 8 CONTINGENT LIABILITIES

*(The following disclosures within Note 8-Contingent Liabilities are identical to the disclosures within Firearms Litigation in Item 2-Management s Discussion and Analysis of Financial Condition and Results of Operations.)*

As of September 30, 2007, the Company is a defendant in approximately 5 lawsuits involving its products and is aware of certain other such claims. These lawsuits and claims fall into two categories:

(i) those that claim damages from the Company related to allegedly defective product design which stem from a specific incident. Pending lawsuits and claims are based principally on the theory of strict liability but also may be based on negligence, breach of warranty, and other legal theories; and

(ii) those brought by cities or other governmental entities, and individuals against firearms manufacturers, distributors and dealers seeking to recover damages allegedly arising out of the misuse of firearms by third parties in the commission of homicides, suicides and other shootings involving juveniles and adults. The complaints by municipalities seek damages, among other things, for the costs of medical care, police and emergency services, public health services, and the maintenance of courts, prisons, and other services. In certain instances, the plaintiffs seek to recover for decreases in property values and loss of business within the city due to criminal violence. In addition, nuisance abatement and/or injunctive relief is sought to change the design, manufacture, marketing and distribution practices of the various defendants. These suits allege, among other claims, strict liability or negligence in the design of products, public nuisance, negligent entrustment, negligent distribution, deceptive or fraudulent advertising, violation of consumer protection statutes and conspiracy or concert of action theories. Most of these cases do not allege a specific injury to a specific individual as a result of the misuse or use of any of the Company s products.

The Company has expended significant amounts of financial resources and management time in connection with product liability litigation. Management believes that, in every case involving firearms, the allegations are unfounded, and that the shootings and any results therefrom were due to negligence or misuse of the firearms by third-parties or the claimant, and that there should be no recovery against the Company. Defenses further exist to the suits brought by governmental entities based, among other reasons, on established state law precluding recovery for essential government services, the remoteness of the claims, the types of damages sought to be recovered, and limitations on the extraterritorial authority which may be exerted by a city, municipality, county or state under state and federal law, including State and Federal Constitutions.

The only case against the Company alleging liability for criminal shootings by third-parties to ever be permitted to go before a constitutional jury, Hamilton, et al. v. Accu-tek, et al., resulted in a defense verdict in favor of the Company on February 11, 1999. In that case, numerous firearms manufacturers and distributors had been sued, alleging damages as a result of alleged negligent sales practices and industry-wide liability. The Company and its marketing and distribution practices were exonerated from any claims of negligence in each of the seven cases decided by the jury. In subsequent proceedings involving other defendants, the New York Court of Appeals as a matter of law confirmed that 1) no legal duty existed under the circumstances to prevent or investigate criminal misuses of a manufacturer s lawfully made products; and 2) liability of firearms manufacturers could not be apportioned under a market share theory. More recently, the New York Court of Appeals on October 21, 2003 declined to hear the appeal from the decision of the New York Supreme Court, Appellate Division, affirming the dismissal of New York Attorney General Eliot Spitzer s public nuisance suit against the Company and other

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manufacturers and distributors of firearms. In its decision, the Appellate Division relied heavily on Hamilton in concluding that it was legally inappropriate, impractical, unrealistic and unfair to attempt to hold firearms manufacturers responsible under theories of public nuisance for the criminal acts of others.

Of the lawsuits brought by municipalities, counties or a state Attorney General, twenty have been concluded: Atlanta dismissal by intermediate Appellate Court, no further appeal; Bridgeport dismissal affirmed by Connecticut Supreme Court; County of Camden dismissal affirmed by U.S. Third Circuit Court of Appeals; Miami dismissal affirmed by intermediate appellate court, Florida Supreme Court declined review; New Orleans dismissed by Louisiana Supreme Court, United States Supreme Court declined review; Philadelphia U.S. Third Circuit Court of Appeals affirmed dismissal, no further appeal; Wilmington dismissed by trial court, no appeal; Boston voluntary dismissal with prejudice by the City at the close of fact discovery; Cincinnati voluntarily withdrawn after a unanimous vote of the city council; Detroit dismissed by Michigan Court of Appeals, no appeal; Wayne County dismissed by Michigan Court of Appeals, no appeal; New York State Court of Appeals denied plaintiff s petition for leave to appeal the Intermediate Appellate Court s dismissal, no further appeal; Newark Superior Court of New Jersey Law Division for Essex County dismissed the case with prejudice; City of Camden dismissed on July 7, 2003, not reopened; Jersey City voluntarily dismissed and not re-filed; St. Louis Missouri Supreme Court denied plaintiffs motion to appeal Missouri Appellate Court s affirmance of dismissal; Chicago Illinois Supreme Court affirmed trial court s dismissal; and Los Angeles City, Los Angeles County, San Francisco Appellate Court affirmed summary judgment in favor of defendants, no further appeal; and Cleveland dismissed on January 24, 2006 for lack of prosecution.

The dismissal of the Washington, D.C. municipal lawsuit was sustained on appeal, but individual plaintiffs were permitted to proceed to discovery and attempt to identify the manufacturers of the firearms used in their shootings as machine guns under the city s strict liability law. On April 21, 2005, the D.C. Court of Appeals, in an *en* banc hearing, unanimously dismissed all negligence and public nuisance claims, but let stand individual claims based upon a Washington, D.C. act imposing strict liability for manufacturers of machine guns. Based on present information, none of the Company s products has been identified with any of the criminal assaults which form the basis of the individual claims. The writ of certiorari to the United States Supreme Court regarding the constitutionality of the Washington, D.C. act was denied and the case was remanded to the trial court for further proceedings. The defendants subsequently moved to dismiss the case based upon the Protection of Lawful Commerce in Arms Act, which motion was granted on May 22, 2006. The individual plaintiffs and the District of Columbia, which has subrogation claims in regard to the individual plaintiffs, have appealed.

The Indiana Court of Appeals affirmed the dismissal of the Gary case by the trial court, but the Indiana Supreme Court reversed this dismissal and remanded the case for discovery proceedings on December 23, 2003. Gary is scheduled to begin trial in 2009. The defendants filed a motion to dismiss pursuant to the Protection of Lawful Commerce in Arms Act ( PLCAA ). The state court judge held the PLCAA unconstitutional and the defendants filed a motion with the Indiana Court of Appeals asking it to accept interlocutory appeal on the issue, which appeal was accepted on February 5, 2007.

In the previously reported New York City municipal case, the defendants moved to dismiss the suit pursuant to the Protection of Lawful Commerce in Arms Act. The trial judge found the Act to be constitutional but denied the defendants motion to dismiss the case, stating that the Act was not applicable to the suit. The defendants were given leave to appeal and in fact have appealed the decision to the U.S. Court of Appeals for the Second Circuit. That appeal remains pending.

In the NAACP case, on May 14, 2003, an advisory jury returned a verdict rejecting the NAACP s claims. On July 21, 2003, Judge Jack B. Weinstein entered an order dismissing the NAACP lawsuit, but this order contained lengthy dicta which defendants believe are contrary to law and fact. Appeals by both sides were filed, but plaintiffs withdrew their appeal. On August 3, 2004, the United States Court of Appeals for the Second Circuit granted the NAACP s motion to dismiss the defendants appeal of Judge Weinstein s order denying defendants motion to

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strike his dicta made in his order dismissing the NAACP s case, and the defendants motion for summary disposition was denied as moot. The ruling of the Second Circuit effectively confirmed the decision in favor of defendants and brought this matter to a conclusion.

Legislation has been passed in approximately 34 states precluding suits of the type brought by the municipalities mentioned above. On the Federal level, the Protection of Lawful Commerce in Arms Act was signed by President Bush on October 26, 2005. The Act requires dismissal of suits against manufacturers arising out of the lawful sale of their products for harm resulting from the criminal or unlawful misuse of a firearm by a third party. The Company is pursuing dismissal of each action involving such claims, including the municipal cases described above. The Company was voluntarily dismissed with prejudice on March 23, 2007 from the previously reported Arnold case. The matter was thus concluded with no payment by the Company.

Punitive damages, as well as compensatory damages, are demanded in certain of the lawsuits and claims. Aggregate claimed amounts presently exceed product liability accruals and applicable insurance coverage. For claims made after July 10, 2000, coverage is provided on an annual basis for losses exceeding $5 million per claim, or an aggregate maximum loss of $10 million annually, except for certain new claims which might be brought by governments or municipalities after July 10, 2000, which are excluded from coverage.

Product liability claim payments are made when appropriate if, as, and when claimants and the Company reach agreement upon an amount to finally resolve all claims. Legal costs are paid as the lawsuits and claims develop, the timing of which may vary greatly from case to case. A time schedule cannot be determined in advance with any reliability concerning when payments will be made in any given case.

Provision is made for product liability claims based upon many factors related to the severity of the alleged injury and potential liability exposure, based upon prior claim experience. Because our experience in defending these lawsuits and claims is that unfavorable outcomes are typically not probable or estimable, only in rare cases is an accrual established for such costs. In most cases, an accrual is established only for estimated legal defense costs. Product liability accruals are periodically reviewed to reflect then-current estimates of possible liabilities and expenses incurred to date and reasonably anticipated in the future. Threatened product liability claims are reflected in our product liability accrual on the same basis as actual claims; i.e., an accrual is made for reasonably anticipated possible liability and claims-handling expenses on an ongoing basis.

A range of reasonably possible loss relating to unfavorable outcomes cannot be made. Currently, there are no product liability cases in which a dollar amount of damages is claimed. If there were cases with claimed damages, the amount of damages claimed would be set forth as an indication of possible maximum liability that the Company might be required to incur in these cases (regardless of the likelihood or reasonable probability of any or all of this amount being awarded to claimants) as a result of adverse judgments that are sustained on appeal.

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

The Company has reported all cases instituted against it through June 30, 2007 and the results of those cases, where terminated, to the S.E.C. on its previous Form 10-K and 10-Q reports, to which reference is hereby made.

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NOTE 9 RELATED PARTY TRANSACTIONS

On March 8, 2007, the Company sold 42 parcels of non-manufacturing real property for $7.3 million to William B. Ruger, Jr., the Company s former Chief Executive Officer and Chairman of the Board. The sales price was based upon an independent appraisal. The sale included substantially all of the Company s non-manufacturing real property assets in New Hampshire. The Company recognized a gain of $5.2 million on the sale. Also in 2007, the Company sold several pieces of artwork to members of the Ruger family for $0.2 million and recognized insignificant gains from these sales.

NOTE 10 OPERATING SEGMENT INFORMATION

The Company has two reportable segments: firearms and investment castings. The firearms segment manufactures and sells rifles, pistols, revolvers, and shotguns principally to a select number of independent wholesale distributors primarily located in the United States. The investment castings segment consists of one operating division that manufactures and sells steel investment castings. In July 2006, the Company announced the cessation of titanium castings operations. Production of titanium castings was completed in the first quarter of 2007. Sales of titanium castings for the remainder of 2007 will be insignificant. The Company continues to manufacture and sell steel investment castings. Selected operating segment financial information follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Net Sales | | | | |
| Firearms | $ 29,298 | $ 34,378 | $ 112,535 | $ 104,425 |
| Castings | | | | |
| Unaffiliated | 2,565 | 7,234 | 9,892 | 19,890 |
| Intersegment | 2,639 | 2,330 | 6,719 | 10,386 |
| | 5,204 | 9,564 | 16,611 | 30,276 |
| Eliminations | (2,639) | (2,330) | (6,719) | (10,386) |
| | $ 31,863 | $ 41,612 | 122,427 | $ 124,315 |
| Income (Loss) Before Income Taxes | | | | |
| Firearms | $ 4,228 | $ 627 | $ 20,952 | $ 5,639 |
| Castings | (915) | 540 | (2,568) | (717) |
| Corporate | (5,055) | 431 | 1,897 | 1,463 |
| | ($ 1,742) | $ 1,598 | $ 20,281 | $ 6,385 |

| | September 30, 2007 | December 31, 2006 |
|---|---|---|
| Identifiable Assets | | |
| Firearms | $ 43,252 | $ 53,525 |
| Castings | 6,600 | 17,154 |
| Corporate | 75,315 | 46,387 |

| | $ | 125,167 | $ | 117,066 |
|---|---|---|---|---|

NOTE 11 NON-RECURRING EVENT

On April 16, 2007, the Company sold a non-manufacturing facility in Arizona for $5.0 million. This facility had not been used in the Company s operations for several years. The Company realized a gain of approximately $1.5 million from this sale in the second quarter of 2007.

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

**Company Overview**

Sturm, Ruger & Company, Inc. (the Company ) is principally engaged in the design, manufacture, and sale of firearms and investment castings. The Company s design and manufacturing operations are located in the United States. Sales for the three months ended September 30, 2007 were 94% domestic and 6% export. Sales for the nine months ended September 30, 2007 were 95% domestic and 5% export. The Company s firearms are sold through a select number of Federally licensed independent wholesale distributors principally to the commercial sporting market.

The Company s investment castings segment provides major components for many of the Company s firearms. To operate this segment more cost-effectively, some of its capacity is used to manufacture investment castings that are sold either directly to or through manufacturers representatives to companies in a variety of industries. Investment casting sales to these third parties for the three and nine months ended September 30, 2007 were 8% of total sales. These sales did not contribute significantly to earnings.

In July 2006, the Company announced the cessation of titanium castings operations. Production of these items was completed in the first quarter of 2007. Sales of titanium castings for the remainder of 2007 will be insignificant. The Company consolidated its Arizona casting operations in its New Hampshire foundry during the first half of 2007. In the third quarter of 2007, the Company recognized an asset impairment charge of $0.5 million related to certain assets remaining in its Arizona foundry. The Company continues to manufacture and sell steel investment castings.

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

The Company experiences differing seasonality in various firearms product lines, typically related to their end-use applications, with the overall net effect being moderately lower firearms demand in the third quarter of the year.

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**Results of Operations**

Summary Unit Data

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

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | Q3 | Q2 | Q1 | Q4 |
| Units Ordered | 80,927 | 115,312 | 175,729 | 125,815 |
| Units Produced | 100,781 | 131,999 | 127,237 | 97,977 |
| Units Shipped | 98,590 | 129,649 | 141,736 | 116,531 |
| Units Company Inventory | 45,264 | 43,073 | 40,723 | 55,222 |
| Units Distributor Inventory | 70,461 | 78,805 | 59,987 | 57,126 |
| Units on Backorder | 35,670 | 53,386 | 68,284 | 34,902 |
| Castings Setups | 42,752 | 37,249 | 27,232 | 30,992 |

Note: Distributor ending inventory as provided by the Company s distributors.

Orders Received and Backlog

In prior years, the Company received one cancelable annual firearms order in December from each of its distributors. Effective December 1, 2006, the Company changed the manner in which distributors order firearms, and began receiving firm, non-cancelable purchase orders on a frequent basis, with most orders for immediate delivery. The gross value of orders received and ending backlog for the trailing four quarters are as follows (in millions, including Federal Excise Tax):

Firearms Orders Received and Ending Backlog

| | 2007 | | | 2006 |
|---|---|---|---|---|
| | Q3 | Q2 | Q1 | Q4 |
| Orders Received | $25.4 | $39.1 | $58.9 | $45.2 |
| Ending Backlog | $16.2 | $23.3 | $27.9 | $16.2 |

Because of the aforementioned change in the manner in which distributors now order firearms, comparable data for prior periods is not meaningful.

The Company believes that the aggregate decline in order value received and units ordered is attributable to a combination of the following factors:

1) the Company s inability to produce and ship sufficient quantities of certain firearms already on order, which discouraged additional orders for those products,

2) softening of demand in some of the market segments in which the Company participates,

3) softening of demand specific to certain of the Company s older product designs, and

4) normal seasonality of the firearms industry, with lower third quarter demand.

The Company cannot ascertain the degree to which each of these factors contributed to the aggregate decline in order value received and units ordered. Many firearms product lines saw a decline in demand; however, there was strong demand for certain firearms product lines.

An increase in firearm sales in future periods is partly dependent on the Company s ability to increase the rate of incoming orders.

Production

Certain product lines saw a decline in demand as the Company fulfilled open orders, built safety stocks of finished goods, and replenished distributor inventory. In response, the Company deliberately reduced its rate of production for many of these models. This planned reduction in output was achieved with little unfavorable impact on gross margin.

Other product lines saw continued strong demand and the Company was unable to produce these products in sufficient quantities to materially reduce their backlog. In many cases the Company s rate of production for these products declined, principally because of a shortage of associated component parts. This unplanned decrease in the rate of production negatively impacted the results of the quarter ended September 30, 2007, and is expected to continue to depress operating results until improved. It is uncertain when higher levels of production will be achieved.

An increase in firearm unit shipments in near-term future periods is largely dependent on the Company s ability to increase unit production of those models in strong demand.

Sales

Consolidated net sales were $31.9 million for the three months ended September 30, 2007. This represents a decrease of $9.7 million or 23.4% from consolidated net sales of $41.6 million in the comparable prior year period.

For the nine months ended September 30, 2007, consolidated net sales were $122.4 million, a decrease of $1.9 million or 1.5% over sales of $124.3 million in the comparable 2006 period.

Firearms segment net sales were $29.3 million for the three months ended September 30, 2007. This represents a decrease of $5.1 million or 14.8% from firearm net sales of $34.4 million in the comparable prior year period.

For the nine months ended September 30, 2007, firearms segment net sales were $112.5 million. This represents an increase of $8.1 million or 7.8% from 2006 firearm net sales of $104.4 million in the comparable 2006 period.

Firearms unit shipments decreased 19.4% for the three months ended September 30, 2007 when compared to the third quarter of 2006. Rifle shipments decreased 26.0% from the comparable prior year period due to the sale of certain models which were discontinued in the third quarter of 2006. Revolver shipments decreased 36.0% from the

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comparable prior year period when demand and availability for Vaquero revolvers was stronger than it was in the third quarter of 2007. Pistol shipments increased 33.0% from the comparable prior year period, due largely to two pistol promotions which were in effect during the quarter ended September 30, 2007. Due to the depletion of safety stock of certain models in strong demand during the first half of 2007, the one-week annual-maintenance shutdown at our largest firearms plant in August hindered overall firearm shipments for the quarter ended September 30, 2007.

For the nine months ended September 30, 2007, firearms unit shipments increased 3.0% from the comparable 2006 period. Rifle shipments increased 5.0% from the comparable prior year period. Revolver shipments decreased 10.0% from the 2006 period despite the 2006 shipment of 5,000 discontinued revolvers.

Casting segment net sales were $2.6 million for the three months ended September 30, 2007. This represents a decrease of $4.6 million or 64.5% from casting sales of $7.2 million in the comparable prior year period.

For the nine months ended September 30, 2007, casting segment net sales were $9.9 million. This represents a decrease of $10.0 million or 50.3% from casting sales of $19.9 million in the comparable prior year period.

The casting sales decrease in both the three and nine months ended September 30, 2007, reflects the cessation of titanium casting operations, as previously announced by the Company in July 2006. Titanium casting sales accounted for $0.5 million or 20.0% of casting sales for the three months ended September 30, 2007, and $4.2 million or 58.0% of total casting sales in the comparable prior year period. For the nine months ended September 30, 2007, titanium casting sales were $3.2 million or 32.0% of total casting sales compared to $9.8 million or 49.0% in the comparable 2006 period. The Company continues to manufacture and sell steel investment castings.

Cost of Products Sold and Gross Margin

Consolidated cost of products sold was $26.3 million for the three months ended September 30, 2007. This represents a decrease of $9.1 million or 25.8% from consolidated cost of products sold of $35.4 million in the comparable prior year period.

For the nine months ended September 30, 2007, consolidated cost of products sold was $88.1 million. This represents a decrease of $11.5 million or 11.5% from consolidated cost of products sold of $99.6 million in the comparable prior year period.

Gross margin as a percent of sales was 17.6% and 28.0% for the three and nine months ended September 30, 2007, respectively. This represents increases from the gross margin of 14.9% and 19.9% in the comparable prior year periods as illustrated below (in thousands):

| Three Months Ended September 30, | 2007 | | 2006 | |
|---|---|---|---|---|
| Net sales | $ 31,863 | 100.0% | $ 41,612 | 100.0% |
| Total cost of products sold, before LIFO and overhead rate adjustments to inventory and product liability | (25,462) | (79.9)% | (33,328) | (80.1)% |
| Performance gross margin * | 6,401 | 20.1% | 8,284 | 19.9% |
| LIFO income (expense) | 237 | 0.7% | (664) | (1.6)% |
| Overhead rate adjustments to inventory | (760) | (2.3)% | (1,073) | (2.6)% |
| Product liability | (283) | (0.9)% | (348) | (0.8)% |
| Gross margin | $ 5,595 | 17.6% | $ 6,199 | 14.9% |

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| Nine Months Ended September 30, | 2007 | | 2006 | |
|---|---|---|---|---|
| Net sales | $122,427 | 100.0% | $124,315 | 100.0% |
| Total cost of products sold, before LIFO and overhead rate adjustments to inventory and product liability | (92,504) | (75.6)% | (92,122) | (74.1)% |
| Performance gross margin* | 29,923 | 24.4% | 32,193 | 25.9% |
| LIFO income (expense) | 10,805 | 8.8% | (3,331) | (2.6)% |
| Overhead rate adjustments to inventory | (4,986) | (4.0)% | (2,307) | (1.9)% |
| Product liability | (1,455) | (1.2)% | (1,828) | (1.5)% |
| Gross margin | $ 34,287 | 28.0% | $ 24,727 | 19.9% |

* Performance Gross Margin is a measure of gross margin before taking into account the impact of LIFO and overhead rate adjustments to inventory, and before product liability expenses.

Performance Gross Margin During the three and nine months ended September 30, 2007, performance gross margin was consistent with the comparable prior year periods.

LIFO During the three and nine months ended September 30, 2007, gross inventories were reduced by $0.4 million and $27.0 million, respectively, compared to decreases in gross inventories of $10.2 million and $5.9 million in the comparable prior year periods. The 2007 reduction resulted in LIFO income and decreased cost of products sold of $0.2 million and $10.8 million for the three and nine months ended September 30, 2007, respectively. LIFO expense of $0.7 million and $3.3 million resulted in an increase in cost of products sold in the comparable prior year periods. Inventories are not expected to fluctuate materially during the fourth quarter of 2007.

Overhead Rate Change The change in inventory value as a result of a change in the overhead rate used to absorb overhead expenses into inventory remaining on the balance sheet for the three and nine months ended September 30, 2007, were reductions of $0.8 million and $5.0, respectively, which recognized the continued progress made in lowering overhead rates. These reductions in inventory value resulted in increases to cost of products sold.

The change in inventory value as a result of a change in the overhead rate used to absorb overhead expenses into inventory remaining on the balance sheet in the three and nine months ended September 30, 2006, were decreases of $1.1 million and $2.3 million, respectively. These reductions in inventory value resulted in increases to cost of products sold.

Product Liability During the three and nine months ended September 30, 2007, the Company incurred product liability expense of $0.3 million and $1.5 million, respectively, which includes the cost of outside legal fees, insurance, and other expenses incurred in the management and defense of product liability matters. For the comparable 2006 periods, product liability expenses totaled $0.3 million and $1.8 million, respectively.

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $6.5 million and $21.2 million for the three and nine months ended September 30, 2007, respectively. This represents increases of $0.6 million and $0.9 million from selling, general and administrative expenses of $5.9 million and $20.3 million in the comparable prior year periods. The increase for the three months ended September 30, 2007, reflects increased firearms promotional expenses.

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The increase in selling, general and administrative expenses for the nine months ended September 30, 2007, reflects increased personnel-related costs, partially offset by reductions in advertising and sales promotion expenses. The increased personnel costs for the nine months ended September 30, 2007, includes $1.1 million of severance costs incurred in the first quarter of 2007 related to the previously announced reduction-in-force program, offset by the $0.7 million expense incurred in the first quarter of 2006 related to the retirement of the Company s former Chairman and Chief Executive Officer.

Pension Curtailment Charge

During the quarter ended September 30, 2007, the Company amended its hourly and salaried defined benefit pension plans so that employees will no longer accrue benefits under these plans effective December 31, 2007. This action, which will freeze the benefits for essentially all employees, will also prevent future hires from joining the plans, effective December 31, 2007. Starting in 2008, the Company will provide supplemental discretionary contributions to substantially all employees individual 401(k) accounts.

These amendments resulted in a $1.2 million pension curtailment charge that was recognized in the quarter ended September 30, 2007.

In 2008 and future years, the Company will likely be required to make cash contributions to the two defined benefit pension plans. The total amount of these future cash contributions will be dependent on the investment returns generated by the plans assets and the then-applicable discount rates used to calculate the plans liabilities, but could be as high as $10 million in aggregate.

In future years, the total annual cash outlays for retirement benefits, which would include the continuing funding of the two defined benefit pension plans and the new supplemental discretionary 401(k) contributions, are expected to be comparable to the current retirement funding levels.

The Company anticipates terminating the two defined benefit pension plans in the future when they are more fully funded. When the plans are terminated, the Company will likely incur a plan termination charge. This charge, which would be as much as $15 million to $20 million if the plans were terminated today, will likely be much less when actually terminated. Notwithstanding the aforementioned termination charge, the Company s annual retirement benefit expense is not expected to increase materially in the foreseeable future.

Impairment of Assets

In the quarter ended September 30, 2007, the Company recognized an asset impairment charge of $0.5 million related to certain tooling and other equipment remaining in its Arizona foundry that the Company now believes will not be recoverable.

Other Income

Other income-net for the three and nine months ended September 30, 2007, was $0.8 million and $8.9 million, respectively. This represents a decrease of $0.4 million and an increase of $6.9 million from other income-net of $1.3 million and $2.0 million, respectively, in the comparable prior year periods. The decrease for the quarter ended September 30, 2007, is attributable to the gain on the sale of excess casting machinery and equipment in the third quarter of 2006. The increase for the nine months ended September 30, 2007, is primarily attributable to a $5.2 million gain on the sale of non-manufacturing real property in March 2007, a $1.5 million gain on the sale of non-manufacturing real property in April 2007, and increased income from short-term investments as a result of increased principal invested at higher interest rates.

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Income Taxes and Net Income

The effective income tax rates for the nine months ended September 30, 2007, is 38.0%. The Company s 2007 effective tax rate is lower than the 2006 effective tax rate of 40.1% principally as a result of increased benefit of Federal manufacturing income tax credits.

As a result of the foregoing factors, net income was ($0.6) million and $12.6 million for the three and nine months ended September 30, 2007, respectively. This represents a decrease of $1.6 million and an increase of $8.8 million from net income of $1.0 million and $3.8 million in the comparable prior year periods.

**Financial Condition**

Operations

At September 30, 2007, the Company had cash, cash equivalents and short-term investments of $63.6 million. The Company s pre-LIFO working capital of $124.9 million, less the LIFO reserve of $45.1 million, results in working capital of $79.8 million and a current ratio of 5.5 to 1.

Cash provided by operating activities was $26.0 million and $11.4 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in cash provided for the nine months ended September 30, 2007 is principally a result of a decrease in inventory, improved net income, and various fluctuations in operating asset and liability accounts during the first nine months of 2007 compared to the first nine months of 2006.

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

Investing and Financing

Capital expenditures for the nine months ended September 30, 2007, totaled $3.1 million. For the past two years, capital expenditures averaged approximately $1 million per quarter. The Company expects to spend approximately $1 million on capital expenditures during the remainder of 2007 to purchase tooling for new product introductions and to upgrade and modernize manufacturing equipment, primarily at the Newport Firearms and Pine Tree Castings Divisions. The Company finances, and intends to continue to finance, these activities with funds provided by operations, current cash, and short-term investments.

On January 26, 2007, the Company announced that its Board of Directors authorized a stock repurchase program. The program allows the Company to repurchase up to $20 million of its common stock from time to time on the open market or through privately negotiated transactions. No shares were repurchased during the nine months ended September 30, 2007.

On March 8, 2007, the Company sold 42 parcels of non-manufacturing real property for $7.3 million to William B. Ruger, Jr., the Company s former Chief Executive Officer and Chairman of the Board. The sale included substantially all of the Company s non-manufacturing real property assets in New Hampshire. The sales price was based upon an independent appraisal, and the Company recognized a gain of $5.2 million on the sale.

On April 16, 2007, the Company sold a non-manufacturing facility in Arizona for $5.0 million. This facility had not been used in the Company s operations for several years. The Company realized a gain of approximately $1.5 million and net cash of $4.6 million from this sale.

During the quarter ended September 30, 2007, the Company amended its hourly and salaried defined benefit pension plans so that employees will no longer accrue benefits under them effective December 31, 2007. This action, which will freeze the benefits for substantially all employees, will also prevent future hires from joining the plans, effective December 31, 2007. Starting in 2008, the Company will provide supplemental discretionary contributions to substantially all employees individual 401(k) accounts.

The Company plans on contributing $5 million to its defined benefit pension plans in the fourth quarter of 2007. In 2008 and future years, the Company will likely be required to make cash contributions to the two defined benefit pension plans. The total amount of these future cash contributions will be dependent on the investment returns generated by the plans assets and the then-applicable discount rates used to calculate the plans liabilities, but could be as high as $10 million in aggregate.

In future years, the total annual cash outlays for retirement benefits, which would include the continuing funding of the two defined benefit pension plans and the new supplemental discretionary 401(k) contributions, are expected to be comparable to the current retirement funding levels.

There were no dividends paid for the nine months ended September 30, 2007. The payment of future dividends depends on many factors, including consistent quarterly operating earnings, internal estimates of future performance, then-current cash and short-term investments, and the Company s need for funds. The Company does not expect to pay dividends in the near term, but will reconsider a dividend from time to time.

Historically, the Company has not required external financing. Based on its unencumbered assets, the Company believes it has the ability to raise substantial amounts of cash through the issuance of short-term or long-term debt.

Firearms Litigation

*(The following disclosures within Firearms Litigation are identical to the disclosures within Note 8-Contingent Liabilities.)*

As of September 30, 2007, the Company is a defendant in approximately 5 lawsuits involving its products and is aware of certain other such claims. These lawsuits and claims fall into two categories:

(iii) those that claim damages from the Company related to allegedly defective product design which stem from a specific incident. Pending lawsuits and claims are based principally on the theory of strict liability but also may be based on negligence, breach of warranty, and other legal theories; and

(iv) those brought by cities or other governmental entities, and individuals against firearms manufacturers, distributors and dealers seeking to recover damages allegedly arising out of the misuse of firearms by third parties in the commission of homicides, suicides and other shootings involving juveniles and adults. The complaints by municipalities seek damages, among other things, for the costs of medical care, police and emergency services, public health services, and the maintenance of courts, prisons, and other services. In certain instances, the plaintiffs seek to recover for decreases in property values and loss of business within the city due to criminal violence. In addition, nuisance abatement and/or injunctive relief is sought to change the design, manufacture, marketing and distribution practices of the various defendants. These suits allege,

among other claims, strict liability or negligence in the design of products, public nuisance, negligent entrustment, negligent distribution, deceptive or fraudulent advertising, violation of consumer protection statutes and conspiracy or concert of action theories. Most of these cases do not allege a specific injury to a specific individual as a result of the misuse or use of any of the Company s products.

The Company has expended significant amounts of financial resources and management time in connection with product liability litigation. Management believes that, in every case involving firearms, the allegations are unfounded, and that the shootings and any results therefrom were due to negligence or misuse of the firearms by third-parties or the claimant, and that there should be no recovery against the Company. Defenses further exist to the suits brought by governmental entities based, among other reasons, on established state law precluding recovery for essential government services, the remoteness of the claims, the types of damages sought to be recovered, and limitations on the extraterritorial authority which may be exerted by a city, municipality, county or state under state and federal law, including State and Federal Constitutions.

The only case against the Company alleging liability for criminal shootings by third-parties to ever be permitted to go before a constitutional jury, Hamilton, et al. v. Accu-tek, et al., resulted in a defense verdict in favor of the Company on February 11, 1999. In that case, numerous firearms manufacturers and distributors had been sued, alleging damages as a result of alleged negligent sales practices and industry-wide liability. The Company and its marketing and distribution practices were exonerated from any claims of negligence in each of the seven cases decided by the jury. In subsequent proceedings involving other defendants, the New York Court of Appeals as a matter of law confirmed that 1) no legal duty existed under the circumstances to prevent or investigate criminal misuses of a manufacturer s lawfully made products; and 2) liability of firearms manufacturers could not be apportioned under a market share theory. More recently, the New York Court of Appeals on October 21, 2003 declined to hear the appeal from the decision of the New York Supreme Court, Appellate Division, affirming the dismissal of New York Attorney General Eliot Spitzer s public nuisance suit against the Company and other manufacturers and distributors of firearms. In its decision, the Appellate Division relied heavily on Hamilton in concluding that it was legally inappropriate, impractical, unrealistic and unfair to attempt to hold firearms manufacturers responsible under theories of public nuisance for the criminal acts of others.

Of the lawsuits brought by municipalities, counties or a state Attorney General, twenty have been concluded: Atlanta dismissal by intermediate Appellate Court, no further appeal; Bridgeport dismissal affirmed by Connecticut Supreme Court; County of Camden dismissal affirmed by U.S. Third Circuit Court of Appeals; Miami dismissal affirmed by intermediate appellate court, Florida Supreme Court declined review; New Orleans dismissed by Louisiana Supreme Court, United States Supreme Court declined review; Philadelphia U.S. Third Circuit Court of Appeals affirmed dismissal, no further appeal; Wilmington dismissed by trial court, no appeal; Boston voluntary dismissal with prejudice by the City at the close of fact discovery; Cincinnati voluntarily withdrawn after a unanimous vote of the city council; Detroit dismissed by Michigan Court of Appeals, no appeal; Wayne County dismissed by Michigan Court of Appeals, no appeal; New York State Court of Appeals denied plaintiff s petition for leave to appeal the Intermediate Appellate Court s dismissal, no further appeal; Newark Superior Court of New Jersey Law Division for Essex County dismissed the case with prejudice; City of Camden dismissed on July 7, 2003, not reopened; Jersey City voluntarily dismissed and not re-filed; St. Louis Missouri Supreme Court denied plaintiffs motion to appeal Missouri Appellate Court s affirmance of dismissal; Chicago Illinois Supreme Court affirmed trial court s dismissal; and Los Angeles City, Los Angeles County, San Francisco Appellate Court affirmed summary judgment in favor of defendants, no further appeal; and Cleveland dismissed on January 24, 2006 for lack of prosecution.

The dismissal of the Washington, D.C. municipal lawsuit was sustained on appeal, but individual plaintiffs were permitted to proceed to discovery and attempt to identify the manufacturers of the firearms used in their shootings as machine guns under the city s strict liability law. On April 21, 2005, the D.C. Court of Appeals, in an *en* banc hearing, unanimously dismissed all negligence and public nuisance claims, but let stand individual claims based upon a Washington, D.C. act imposing strict liability for manufacturers of machine guns. Based

on present information, none of the Company s products has been identified with any of the criminal assaults which form the basis of the individual claims. The writ of certiorari to the United States Supreme Court regarding the constitutionality of the Washington, D.C. act was denied and the case was remanded to the trial court for further proceedings. The defendants subsequently moved to dismiss the case based upon the Protection of Lawful Commerce in Arms Act, which motion was granted on May 22, 2006. The individual plaintiffs and the District of Columbia, which has subrogation claims in regard to the individual plaintiffs, have appealed.

The Indiana Court of Appeals affirmed the dismissal of the Gary case by the trial court, but the Indiana Supreme Court reversed this dismissal and remanded the case for discovery proceedings on December 23, 2003. Gary is scheduled to begin trial in 2009. The defendants filed a motion to dismiss pursuant to the Protection of Lawful Commerce in Arms Act ( PLCAA ). The state court judge held the PLCAA unconstitutional and the defendants filed a motion with the Indiana Court of Appeals asking it to accept interlocutory appeal on the issue, which appeal was accepted on February 5, 2007.

In the previously reported New York City municipal case, the defendants moved to dismiss the suit pursuant to the Protection of Lawful Commerce in Arms Act. The trial judge found the Act to be constitutional but denied the defendants motion to dismiss the case, stating that the Act was not applicable to the suit. The defendants were given leave to appeal and in fact have appealed the decision to the U.S. Court of Appeals for the Second Circuit. That appeal remains pending.

In the NAACP case, on May 14, 2003, an advisory jury returned a verdict rejecting the NAACP s claims. On July 21, 2003, Judge Jack B. Weinstein entered an order dismissing the NAACP lawsuit, but this order contained lengthy dicta which defendants believe are contrary to law and fact. Appeals by both sides were filed, but plaintiffs withdrew their appeal. On August 3, 2004, the United States Court of Appeals for the Second Circuit granted the NAACP s motion to dismiss the defendants appeal of Judge Weinstein s order denying defendants motion to strike his dicta made in his order dismissing the NAACP s case, and the defendants motion for summary disposition was denied as moot. The ruling of the Second Circuit effectively confirmed the decision in favor of defendants and brought this matter to a conclusion.

Legislation has been passed in approximately 34 states precluding suits of the type brought by the municipalities mentioned above. On the Federal level, the Protection of Lawful Commerce in Arms Act was signed by President Bush on October 26, 2005. The Act requires dismissal of suits against manufacturers arising out of the lawful sale of their products for harm resulting from the criminal or unlawful misuse of a firearm by a third party. The Company is pursuing dismissal of each action involving such claims, including the municipal cases described above. The Company was voluntarily dismissed with prejudice on March 23, 2007 from the previously reported Arnold case. The matter was thus concluded with no payment by the Company.

Punitive damages, as well as compensatory damages, are demanded in certain of the lawsuits and claims. Aggregate claimed amounts presently exceed product liability accruals and applicable insurance coverage. For claims made after July 10, 2000, coverage is provided on an annual basis for losses exceeding $5 million per claim, or an aggregate maximum loss of $10 million annually, except for certain new claims which might be brought by governments or municipalities after July 10, 2000, which are excluded from coverage.

Product liability claim payments are made when appropriate if, as, and when claimants and the Company reach agreement upon an amount to finally resolve all claims. Legal costs are paid as the lawsuits and claims develop, the timing of which may vary greatly from case to case. A time schedule cannot be determined in advance with any reliability concerning when payments will be made in any given case.

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

defense costs. Product liability accruals are periodically reviewed to reflect then-current estimates of possible liabilities and expenses incurred to date and reasonably anticipated in the future. Threatened product liability claims are reflected in our product liability accrual on the same basis as actual claims; i.e., an accrual is made for reasonably anticipated possible liability and claims-handling expenses on an ongoing basis.

A range of reasonably possible loss relating to unfavorable outcomes cannot be made. Currently, there are no product liability cases in which a dollar amount of damages is claimed. If there were cases with claimed damages, the amount of damages claimed would be set forth as an indication of possible maximum liability that the Company might be required to incur in these cases (regardless of the likelihood or reasonable probability of any or all of this amount being awarded to claimants) as a result of adverse judgments that are sustained on appeal.

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

The Company has reported all cases instituted against it through June 30, 2007 and the results of those cases, where terminated, to the S.E.C. on its previous Form 10-K and 10-Q reports, to which reference is hereby made.

Other Operational Matters

In the normal course of its manufacturing operations, the Company is subject to occasional governmental proceedings and orders pertaining to waste disposal, air emissions and water discharges into the environment. The Company believes that it is generally in compliance with applicable environmental regulations and the outcome of such proceedings and orders will not have a material adverse effect on the financial position or results of operations of the Company.

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

The valuation of the future defined benefit pension obligations at December 31, 2006, indicated that these plans were underfunded by $7.6 million and resulted in a cumulative other comprehensive loss of $12.4 million on the Company s balance sheet at December 31, 2006.

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

The effect of inflation on the Company s operations is most immediately felt in cost of products sold because the Company values inventory on the LIFO basis. Generally under this method, the cost of products sold reported in the financial statements approximates current costs and, thus, reduces distortion in reported income that would result from the slower recognition of increased costs when other methods are used. In the nine months ended September 30, 2007, however, a significant reduction in inventories resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the current cost of purchases. This resulted in LIFO income and decreased cost of products sold of $0.3 million and $10.9 million for the three and nine months ended September 30, 2007, respectively.

Adjustments to Critical Accounting Policies

The Company has not made any adjustments to its critical accounting estimates and assumptions described in the Company s 2006 Annual Report on Form 10-K filed on March 5, 2007, or the judgments affecting the application of those estimates and assumptions.

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ( FAS 157 ) and No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities,* ( FAS 159 ). These Standards define fair value, establish a framework for measuring fair value under generally accepted accounting principles, and expand disclosures about fair value measurements. FAS 157 and FAS 159 are effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of FAS 157 and FAS 159 are not expected to have a material impact on the Company s financial position, results of operations, and 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 including lawsuits filed by mayors, state attorneys general and other governmental entities and membership organizations, and the impact of future firearms control and environmental legislation, any one or more of which could cause actual results to differ materially from those projected. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date made. The Company undertakes no obligation to publish revised forward-looking statements to reflect events or circumstances after the date such forward-looking statements are made or to reflect the occurrence of subsequent unanticipated events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to changes in prevailing market interest rates affecting the return on its investments but does not consider this interest rate market risk exposure to be material to its financial condition or results of operations. The Company invests primarily in a bank-managed money market fund that invests principally in United States Treasury instruments, all maturing within one year. The carrying amount of these investments approximates fair value due to the short-term maturities. Under its current policies, the Company does not use derivative financial instruments, derivative commodity instruments or other financial instruments to manage its exposure to changes in interest rates or commodity prices.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company s management, with the participation of the Company s Chief Executive Officer and Treasurer and Chief Financial Officer, has evaluated the effectiveness of the Company s disclosure controls and procedures (the Disclosure Controls and Procedures ), as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act ), as of the September 30, 2007.

Based on the evaluation, the Company s Chief Executive Officer and Treasurer and Chief Financial Officer have concluded that, as of September 30, 2007, such disclosure controls and procedures are effective to ensure that information required to be disclosed in the Company s periodic reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission s rules and forms. Additionally, the Company s Chief Executive Officer and Treasurer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, there have been no changes in the Company s control over financial reporting that occurred during the quarter ended

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September 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company s control over financial reporting.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The nature of the legal proceedings against the Company is discussed at Note 8 to this Form 10-Q report, which is incorporated herein by reference.

The Company has reported all cases instituted against it through June 30, 2007, and the results of those cases, where terminated, to the S.E.C. on its previous Form 10-Q and 10-K reports, to which reference is hereby made.

No cases were formally instituted against the Company during the three months ending September 30, 2007.

During the three months ending September 30, 2007, no previously reported cases were settled.

ITEM 1A. RISK FACTORS

There have been no material changes in our risk factors from the information provided in Item 1A. Risk Factors included in our Annual Report on Form 10-K for the year ended December 31, 2006.

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

Not applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

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

None

ITEM 5. OTHER INFORMATION

None

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ITEM 6. EXHIBITS

(a) Exhibits:

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

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

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

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

STURM, RUGER & COMPANY, INC.
FORM 10-Q FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2007
SIGNATURES

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

STURM, RUGER & COMPANY, INC.

Date: October 24, 2007

S/THOMAS A. DINEEN

Thomas A. Dineen
Principal Financial Officer,
Vice President, Treasurer and Chief
Financial Officer

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