

STURM RUGER & CO INC

Form 10-Q

August 07, 2006

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended June 30, 2006**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-10435**

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

(Exact name of registrant as specified in its charter)

Delaware

06-0633559

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. employer  
identification no.)

Lacey Place, Southport, Connecticut

06890

(Address of principal executive offices)

(Zip code)

(203) 259-7843

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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  Accelerated filer  Non-accelerated filer

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

The number of shares outstanding of the issuer's common stock as of July 31, 2006: Common Stock, \$1 par value - 26,910,720.

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STURM, RUGER & COMPANY, INC.

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

|   | June 30,<br>2006 | December 31,<br>2005<br>(Note) |
|---|------------------|--------------------------------|
| <b>Assets</b>   |                  |                                |
| Current Assets  |                  |                                |
| Cash and cash equivalents   | \$ 3,314         | \$ 4,057                       |
| Short-term investments  | 28,334           | 21,926                         |
| Trade receivables, less allowances for doubtful accounts (\$370 and \$351) and discounts (\$19 and \$346) | 16,128           | 15,777                         |
| Inventories:  |                  |                                |
| Finished products   | 10,398           | 9,997                          |
| Materials and products in process   | 40,005           | 38,729                         |
|   | 50,403           | 48,726                         |
| Deferred income taxes   | 6,558            | 6,018                          |
| Prepaid expenses and other current assets   | 2,273            | 5,442                          |
| Total current assets  | 107,010          | 101,946                        |
| Property, plant and equipment   | 156,653          | 155,174                        |
| Less allowances for depreciation  | (133,979)        | (131,808)                      |
|   | 22,674           | 23,366                         |
| Deferred income taxes   | 3,000            | 3,200                          |
| Other assets  | 10,358           | 11,127                         |
| Total Assets  | \$ 143,042       | \$ 139,639                     |

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

|  | June 30,<br>2006 | December<br>31,<br>2005<br>(Note) |
|--|------------------|-----------------------------------|
| <b>Liabilities and Stockholders Equity</b>   |                  |                                   |
| Current Liabilities  |                  |                                   |
| Trade accounts payable and accrued expenses  | \$ 3,056         | \$ 3,619                          |
| Product liability  | 988              | 1,207                             |
| Employee compensation and benefits   | 8,487            | 7,544                             |
| Workers compensation   | 5,254            | 5,119                             |
| Income taxes payable   | 1,192            | 935                               |
| <br>Total current liabilities  | <br>18,977       | <br>18,424                        |
| <br>Accrued pension liability  | <br>8,689        | <br>8,648                         |
| Product liability accrual  | 912              | 989                               |
| 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 26,910,700 | 26,911           | 26,911                            |
| Additional paid-in capital   | 2,526            | 2,508                             |
| Retained earnings  | 97,202           | 94,334                            |
| Accumulated other comprehensive income (loss)  | (12,175)         | (12,175)                          |
| <br>Total Stockholders Equity  | <br>114,464      | <br>111,578                       |
| <br>Total Liabilities and Stockholders Equity  | <br>\$ 143,042   | <br>\$ 139,639                    |

Note:

The balance sheet at December 31, 2005 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 INCOME (UNAUDITED)  
 (Dollars in thousands, except per share data)

|                                    | Three Months Ended June |           | Six Months Ended June |           |
|------------------------------------|-------------------------|-----------|-----------------------|-----------|
|                                    | 30,                     | 30,       | 30,                   | 30,       |
|                                    | 2006                    | 2005      | 2006                  | 2005      |
| Firearms sales                     | \$ 29,222               | \$ 28,720 | \$ 70,047             | \$ 67,821 |
| Castings sales                     | 6,054                   | 5,675     | 12,656                | 10,835    |
| Net sales                          | 35,276                  | 34,395    | 82,703                | 78,656    |
| Cost of products sold              | 27,819                  | 28,750    | 66,107                | 61,163    |
| Gross profit                       | 7,457                   | 5,645     | 16,596                | 17,493    |
| Expenses:                          |                         |           |                       |           |
| Selling                            | 3,898                   | 4,149     | 8,017                 | 8,210     |
| General and administrative         | 1,780                   | 1,634     | 4,504                 | 3,262     |
|                                    | 5,678                   | 5,783     | 12,521                | 11,472    |
| Operating income (loss)            | 1,779                   | (138)     | 4,075                 | 6,021     |
| Other income-net                   | 639                     | 135       | 712                   | 121       |
| Income (loss) before income taxes  | 2,418                   | (3)       | 4,787                 | 6,142     |
| Income taxes                       | 970                     | (1)       | 1,919                 | 2,463     |
| Net income (loss)                  | \$ 1,448                | (\$ 2)    | \$ 2,868              | \$ 3,679  |
| Earnings(loss) per share           |                         |           |                       |           |
| Basic                              | \$ 0.06                 | (\$ 0.00) | \$ 0.11               | \$ 0.14   |
| Diluted                            | \$ 0.06                 | (\$ 0.00) | \$ 0.11               | \$ 0.14   |
| Cash dividends per share           | \$ 0.00                 | \$ 0.10   | \$ 0.00               | \$ 0.20   |
| Average shares outstanding (000 s) |                         |           |                       |           |
| Basic                              | 26,911                  | 26,911    | 26,911                | 26,911    |
| Diluted                            | 26,912                  | 26,911    | 26,912                | 26,911    |

See notes to condensed financial statements.

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

|  | Six Months Ended June<br>30, |          |
|--|------------------------------|----------|
|  | 2006                         | 2005     |
| Cash Provided by Operating Activities              | \$ 7,313                     | \$ 6,870 |
| Investing Activities                               |                              |          |
| Property, plant and equipment additions            | (1,648)                      | (1,694)  |
| Purchases of short-term investments                | (63,465)                     | (66,608) |
| Proceeds from maturities of short-term investments | 57,057                       | 66,134   |
| Cash used in investing activities                  | (8,056)                      | (2,168)  |
| Financing Activities                               |                              |          |
| Dividends paid                                     |                              | (5,382)  |
| Cash used by financing activities                  |                              | (5,382)  |
| (Decrease) in cash and cash equivalents            | (743)                        | (680)    |
| Cash and cash equivalents at beginning of period   | 4,057                        | 4,841    |
| Cash and cash equivalents at end of period         | \$ 3,314                     | \$ 4,161 |

See notes to condensed financial statements.

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STURM, RUGER & COMPANY, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2006

**NOTE 1 BASIS OF PRESENTATION**

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

In the opinion of management, the accompanying unaudited condensed financial statements include all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation of the results of the interim periods. Operating results for the six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year ending December 31, 2006. 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, 2005.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES**

Organization: Sturm, Ruger & Company, Inc. ( 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. Substantially all sales are domestic. The Company s firearms are sold through a select number of independent wholesale distributors to the sporting and law enforcement markets. 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.

Principles of Consolidation: The financial statements have been prepared from the Company s books and records and include all of the Company s accounts. All significant intercompany accounts and transactions have been eliminated. Certain prior year balances may have been reclassified to conform with current year presentation.

Stock Incentive and Bonus Plans: At June 30, 2006, the Company has two stock-based compensation plans. Readers should refer to both Item 12 and Note 1 of the Company s financial statements, which are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, for additional information related to these stock-based compensation plans.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement 123(R), *Share-Based Payment*, utilizing the modified prospective approach. Prior to the adoption of SFAS 123(R) the Company accounted for stock option grants in accordance with APB Opinion 25, *Accounting for Stock Issued to Employees*, (the intrinsic value method), and accordingly, recognized no compensation expense for stock option grants.

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## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Under the modified prospective approach, the provisions of SFAS 123(R) apply to new awards and to awards that were outstanding on January 1, 2006 that are subsequently modified, repurchased or cancelled. Under the modified prospective approach, compensation cost recognized in the quarter and six months ended June 30, 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). Prior periods were not restated to reflect the impact of adopting the new standard.

The following table summarizes the stock option activity for the six months ended June 30, 2006:

|  | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Grant<br>Date Fair<br>Value | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(Years) |
|--|-----------|--|--|--|
| Outstanding At December 31, 2005                 | 1,020,000 | \$ 11.50                                 | \$ 1.89  | 3.3  |
| Granted  | 60,000    | 6.15                                     | 2.83   | 10.0   |
| Exercised  |           |  |  |  |
| Canceled   | (315,000) | 11.89                                    | 2.00   | 2.8  |
| Outstanding at June 30, 2006                     | 765,000   | \$ 10.92                                 | \$ 1.90  | 3.6  |
| Exercisable Options Outstanding at June 30, 2006 | 705,000   | \$ 11.23                                 | \$ 1.84  | 3.1  |
| Non-Vested Options at June 30, 2006              | 60,000    | \$ 7.33                                  | \$ 2.68  | 9.8  |

As a result of adopting Statement 123(R) on January 1, 2006, the Company's income before income taxes and net income for the six months ended June 30, 2006 are \$35,000 and \$21,000 lower, respectively, than if it had continued to account for share-based compensation under Opinion 25 for stock option grants. Basic and diluted earnings per share were unchanged.

There were no stock options exercised during the six months ended June 30, 2006. There were 60,000 options granted during the six months ended June 30, 2006.

If the Company would have adopted Statement 123(R) for the six month period ended June 30, 2005, the Company's income before income taxes and net income for that period would have been \$16,000 and \$9,000 lower, respectively, than the amounts previously reported and basic and diluted earnings per share would have been unchanged.

The Company uses the Black-Sholes option pricing model to estimate the fair value of stock-based awards with the following weighted average assumptions: dividend yield of 0.0%, expected volatility of 44.9%, risk free rate of return of 5.0%, and expected lives of 5 years.

Non-vested stock options at June 30, 2006 total 60,000. At June 30, 2006, there was \$231,000 of unrecognized compensation cost related to share-based payments that is expected to be recognized over a weighted-average period

of 2.75 years.

**Table of Contents****NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED**

At June 30, 2006, there were 1.1 million shares available for future stock option grants to employees under existing plans, and no shares available for future stock option grants to directors under existing plans. At June 30, 2006 the aggregate intrinsic value of exercisable options was zero. The Company has reserved 2.2 million of authorized and unissued shares of its common stock for issuance of stock under its stock options plans.

**Recent Accounting Pronouncements:** In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of SFAS No. 109, which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit. The provisions of FIN 48 are effective for the Company as of January 1, 2007. The adoption of FIN 48 is not expected to have a material effect on the Company.

**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.

**NOTE 4 INCOME TAXES**

The Company's 2006 and 2005 effective tax rate differs from the statutory tax rate due principally to state income taxes. Income tax payments totaled \$12,000 for the six months ended June 30, 2006. Total income tax payments during the three months ended June 30, 2005 were \$3.0 million.

**NOTE 5 PENSION PLANS**

The Company sponsors two defined benefit pension plans which cover substantially all employees. A third defined benefit plan is non-qualified and covers certain executive officers of the Company. The estimated cost of these plans is summarized below (in thousands):

|                                    | Three Months Ended June |             | Six Months Ended June |             |
|------------------------------------|-------------------------|-------------|-----------------------|-------------|
|                                    | 2006                    | 30,<br>2005 | 2006                  | 30,<br>2005 |
| Service cost                       | \$ 406                  | \$ 319      | \$ 811                | \$ 665      |
| Interest cost                      | 821                     | 650         | 1,642                 | 1,355       |
| Expected return on plan assets     | (993)                   | (763)       | (1,986)               | (1,592)     |
| Amortization of prior service cost | 65                      | 67          | 131                   | 141         |
| Recognized actuarial gains         | 256                     | 177         | 512                   | 370         |
| Net periodic pension cost          | \$ 555                  | \$ 450      | \$ 1,110              | \$ 939      |

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**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED**

The Company made contributions totaling \$0.5 million related to its defined benefit pension plans in the second quarter of 2006. The Company expects its contribution requirements for its defined benefit pension plans for the balance of 2006 to be approximately \$0.5 million.

**NOTE 6 BASIC AND DILUTED EARNINGS PER SHARE**

Basic earnings per share is based upon the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the impact of options outstanding using the treasury stock method, when applicable. For the three months ended June 30, 2005, the treasury stock method would have been antidilutive, therefore the weighted average number of common shares were used for this period's diluted earnings per share calculation. This resulted in diluted weighted-average shares outstanding for the three and six months ended June 30, 2006 of 26,912,000, and diluted weighted-average shares outstanding for the three and six months ended June 30, 2005 of 26,911,000.

**NOTE 7 COMPREHENSIVE INCOME**

As there were no non-owner changes in equity during the first six months of 2006 and 2005, total comprehensive income(loss) equals net income(loss) for the three and six months ended June 30, 2006 and 2005, or \$1.4 million and \$2.9 million, and \$0 and \$3.7 million, respectively.

**NOTE 8 CONTINGENT LIABILITIES**

As of June 30, 2006, the Company is a defendant in approximately 4 lawsuits allegedly 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. No such lawsuits are presently pending; and
- (ii) those brought by cities, municipalities, counties, 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.

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## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

Management believes that, in every case, 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 cities, municipalities, and counties based, among other reasons, recently enacted Federal legislation established state law precluding recovery by municipalities 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 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 denied plaintiffs' petition for rehearing; 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

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NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

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 have filed a motion to dismiss pursuant to the Protection of Lawful Commerce in Arms Act. The motion is pending.

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 is 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. On June 22, 2006, in the previously reported Arnold case, the motion to dismiss based on the Act was denied. Interlocutory appellate remedies are being pursued.

Punitive damages, as well as compensatory damages, are demanded in many 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.

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.

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## NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED) CONTINUED

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.

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 March 31, 2006 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.

## NOTE 9 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 two operating divisions which manufacture and sell titanium and steel investment castings. Selected operating segment financial information follows (in thousands):

|                                      | Three Months Ended June |             | Six Months Ended June 30, |                         |
|--------------------------------------|-------------------------|-------------|---------------------------|-------------------------|
|                                      | 2006                    | 30,<br>2005 | 2006                      | 2005                    |
| Net Sales                            |                         |             |                           |                         |
| Firearms                             | \$ 29,222               | \$ 28,720   | \$ 70,047                 | \$ 67,821               |
| Castings                             |                         |             |                           |                         |
| Unaffiliated                         | 6,054                   | 5,675       | 12,656                    | 10,835                  |
| Intersegment                         | 3,406                   | 3,007       | 8,056                     | 8,671                   |
|                                      | 9,460                   | 8,682       | 20,712                    | 19,506                  |
| Eliminations                         | (3,406)                 | (3,007)     | (8,056)                   | (8,671)                 |
|                                      | \$ 35,276               | \$ 34,395   | \$ 82,703                 | \$ 78,656               |
| Income (Loss) Before<br>Income Taxes |                         |             |                           |                         |
| Firearms                             | \$ 1,596                | (\$ 209)    | \$ 5,012                  | \$ 6,170                |
| Castings                             | (18)                    | (4)         | (1,257)                   | (337)                   |
| Corporate                            | 840                     | 210         | 1,032                     | 309                     |
|                                      | \$ 2,418                | (\$ 3)      | \$ 4,787                  | \$ 6,142                |
|                                      |                         |             | June 30,<br>2006          | December<br>31,<br>2005 |
| Identifiable Assets                  |                         |             |                           |                         |
| Firearms                             |                         |             | \$ 71,908                 | \$ 73,035               |
| Castings                             |                         |             | 18,945                    | 17,751                  |

|           |            |            |
|-----------|------------|------------|
| Corporate | 52,189     | 48,853     |
|           | \$ 143,042 | \$ 139,639 |

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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 precision investment castings. The Company's design and manufacturing operations are located in the United States. Substantially all sales are domestic.

The Company is the only U.S. firearms manufacturer which offers products in all four industry product categories rifles, shotguns, pistols, and revolvers. The Company's firearms are sold through a select number of independent wholesale distributors principally to the commercial sporting market.

Investment castings manufactured are of titanium and steel alloys. Investment castings are sold either directly or through manufacturers' representatives to companies in a wide variety of industries.

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 does not consider its overall firearms business to be predictably seasonal; however, sales of certain models of firearms are usually lower in the third quarter of the year.

**Results of Operations**

Consolidated net sales of \$35.3 million were achieved by the Company for the three months ended June 30, 2006. This represents an increase of 2.6% from 2005 consolidated net sales of \$34.4 million in the comparable prior year period. Sales for the six month period ended June 30, 2006 were \$82.7 million, an increase of \$4.0 million over sales of \$78.7 million in the comparable 2005 period.

Firearms segment net sales increased by \$0.5 million, or 1.7%, in the second quarter of 2006 to \$29.2 million from \$28.7 million in the second quarter of the prior year. For the six months ended June 30, 2006 firearms segment net sales increased by \$2.2 million, to \$70.0 million from \$67.8 million in the corresponding 2005 period. Firearms unit shipments decreased 8.0% for the three month period ended June 30, 2006 and 3.0% for the six month period ended June 30, 2006 from the comparable 2005 periods. For the quarter ended June 30, 2006, shipments of revolvers and pistols exceeded the second quarter of 2005, while rifle and shotgun shipments were below the second quarter of 2005.

The increase in pistol shipments is attributable to a dealer-driven rebate program announced in June of 2006, and the increase in revolvers is due to greater availability of revolver models in greater demand. The decrease in rifle shipments for the three months ended June 30, 2006 is due to the popularity of a dealer-driven rebate program for 10/22 rifles in effect in May and June of 2005. A favorable shift in product mix, coupled with modest price increases and the modification of our sales discount programs resulted in the 2% increase in sales, despite the reduction in shipments.

For the six months ended June 30, 2006, the increased shipments of revolvers was offset by a decline in shipments of rifles, pistols and shotguns. The decrease in rifle shipments for the six months ended June 30, 2006 is due to the popularity of the aforementioned dealer-driven rebate program for 10/22 rifles in effect in May and June of 2005. The decrease in pistol shipments for the six months ended June 30, 2006 is primarily attributable to the

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

shipment of 5,000 KP95D pistols to the U.S. Army and Tank-automotive and Armaments Command in January of 2005. A favorable shift in product mix, coupled with modest price increases and the modification of our sales discount programs resulted in the 2% increase in sales, despite the reduction in shipments.

Casting segment net sales increased by \$0.4 million or 6.7% to \$6.1 million for the three month period ended June 30, 2006 from the three month period ended June 30, 2005. For the six month period ended June 30, 2006 casting segment net sales increased 16.8% or \$1.9 million to \$12.7 million. Increased sales were primarily generated from existing customers in a variety of industries.

Despite the favorable trend in sales, the Company's inability to develop a realistic and achievable strategic plan for titanium castings has resulted in the decision to cease titanium castings operations. The cessation of titanium casting operations is targeted for the first quarter of 2007. Titanium casting sales accounted for \$5.6 million or 44% of casting sales for the six months ended June 30, 2006.

Consolidated cost of products sold for the three and the six months ended June 30, 2006 were \$27.8 million and \$66.1 million compared to \$28.8 million and \$61.2 million for the three and six months ended June 30, 2005, representing a decrease of 3.2% and an increase of 8.1%. The decrease for the three months ended June 30, 2006 reflects a favorable book-to-physical inventory adjustment recorded in the second quarter of 2006, decreased firearm unit shipments, partially offset by increased firearm and casting production expenses and increased casting sales. The increase for the six months is attributable to increased firearm and casting production expenses and increased casting sales, partially offset by the aforementioned favorable book-to-physical inventory adjustment recorded in the second quarter of 2006.

For the second quarter of 2006, gross profit as a percent of sales increased to 21.1% from 16.4% in the second quarter of 2005. Gross profit as a percentage of net sales was 20.1% for the six month period ended June 30, 2006 as compared to 22.2% in the comparable 2005 period. Margin improvement during the three month period ended June 30, 2006 resulted from the favorable inventory adjustment, partially offset by less efficient firearms and castings production. Gross margin deterioration for the six month period ended June 30, 2006 resulted from less efficient firearms and castings production, partially offset by the aforementioned favorable book-to-physical inventory adjustment recorded in the second quarter of 2006.

Selling, general and administrative expenses were \$5.7 million and \$12.5 million for the three and six months ended June 30, 2006, respectively, representing a decrease of 1.8% for the quarter and an increase of 9.1% for the six months. The slight decrease for the three months ended June 30, 2006 reflects a decline in several marketing initiatives. The increases for the six months ended June 30, 2006 were primarily attributable to increased personnel-related expenses including \$0.7 million related to the retirement of the former Chairman and Chief Executive Officer, and additional firearm promotional expenses.

Other income-net for the three and six months ended June 30, 2006 was \$0.6 million and \$0.7 million, respectively, compared to \$0.1 million for both of the comparable periods ended June 30, 2005. The increase in the quarter and six months is attributable to increased interest rates on the Company's short-term investments and the sale of non-manufacturing real estate in the second quarter of 2006.

The effective income tax rate of 40.1% in the three months and six months ended June 30, 2006 remained consistent with the income tax rate in the corresponding 2005 periods.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

As a result of the foregoing factors, consolidated net income for the three months ended June 30, 2006 increased \$1.4 million from a breakeven for the three months ended June 30, 2005, and decreased \$0.8 million, or 22.1%, from \$3.7 million for the six months ended June 30, 2005 to \$2.9 million for the six months ended June 30, 2006.

**Financial Condition**

**Operations**

At June 30, 2006, the Company had cash, cash equivalents and short-term investments of \$31.6 million, working capital of \$88.0 million and a current ratio of 5.6 to 1.

Cash provided by operating activities was \$7.3 million and \$6.9 million for the six months ended June 30, 2006 and 2005, respectively. The slight increase in cash provided is principally a result of various fluctuations in operating asset and liability accounts during the first six months of 2006 compared to the first six months of 2005.

Until November 30, 2004, the Company followed a common industry practice of offering a dating plan to its firearms customers on selected products, which allowed the customer to buy the products commencing in December, the start of the Company's marketing year, and pay for them on extended terms. Discounts were offered for early payment. The dating plan provided a revolving payment plan under which payments for all shipments made during the period December through February were made by April 30. Shipments made in subsequent months were paid for within a maximum of 120 days. On December 1, 2004, the Company modified the payment terms on these selected products whereby payment was due 45 days after shipment. Discounts were offered for early payment. On December 1, 2005, the Company effectively discontinued the dating plan. The dating plan receivable balance was \$5.9 million at June 30, 2005.

The Company purchases its various raw materials from a number of suppliers. There is, however, a limited supply of these materials in the marketplace at any given time which can cause the purchase prices to vary based upon numerous market factors. The Company believes that it has adequate quantities of raw materials in inventory to provide ample time to locate and obtain additional items at then-current market cost without interruption of its manufacturing operations. However, if market conditions result in a significant prolonged inflation of certain prices or if adequate quantities of raw materials can not be obtained, the Company's manufacturing processes could be interrupted and the Company's financial condition or results of operations could be materially adversely affected.

**Investing and Financing**

Capital expenditures during the six months ended June 30, 2006 totaled \$1.6 million. For the past two years capital expenditures averaged approximately \$1.4 million per quarter. In 2006, the Company expects to spend approximately \$4 million on capital expenditures 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, all of these activities with funds provided by operations and current cash and short-term investments.

There were no dividends paid for the six months ended June 30, 2006. On October 20, 2005, the Company's Board of Directors voted to forgo the quarterly dividend. The payment of future dividends depends on many factors, including internal estimates of future performance, then-current cash and short-term investments, and the Company's need for funds.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

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 short-term or long-term debt. The Company does not anticipate a need for significant external financing for the next twelve months.

**Firearms Legislation**

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 and place certain restrictions on the interstate sale of firearms unless certain licenses are obtained. The Company does not manufacture fully automatic weapons, other than for the law enforcement market, and holds all necessary licenses under these federal laws. From time to time, congressional committees review proposed bills relating to the regulation of firearms. These proposed bills generally seek either to restrict or ban the sale and, in some cases, the ownership of various types of firearms. Several states currently have laws in effect similar to the aforementioned legislation.

Until November 30, 1998, the Brady Law mandated a nationwide five-day waiting period and background check prior to the purchase of a handgun. As of November 30, 1998, the National Instant Check System, which applies to both handguns and long guns, replaced the five-day waiting period. The Company believes that the Brady Law has not had a significant effect on the Company's sales of firearms, nor does it anticipate any impact on sales in the future. The

Crime Bill took effect on September 13, 1994, but none of the Company's products were banned as so-called assault weapons. To the contrary, all the Company's then-manufactured commercially-sold long guns were exempted by name as legitimate sporting firearms. This ban expired by operation of law on September 13, 2004. The Company remains strongly opposed to laws which would restrict the rights of law-abiding citizens to lawfully acquire firearms. 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.

**Firearms Litigation**

The Company is a defendant in approximately four lawsuits allegedly involving its products and is aware of certain other such claims. The Company has expended significant amounts of financial resources and management time in connection with product liability litigation. Management believes that, in every case, 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 cities, municipalities, counties, and a state attorney general based, among other reasons, on established state law precluding recovery by municipalities 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. Also, The Protection of Lawful Commerce in Arms Act signed into law on October 26, 2005 on its face requires dismissal of such claims.

**Table of Contents****MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

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 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 denied plaintiffs' petition for rehearing; 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 have filed a motion to dismiss pursuant to the Protection of Lawful Commerce in Arms Act. The motion is pending.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

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 is 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. On June 22, 2006, in the previously reported Arnold case, the motion to dismiss based on the Act was denied. Interlocutory appellate remedies are being pursued.

**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, 2005 indicated that these plans were underfunded. While this estimation has no bearing on the actual funded status of the pension plans, it resulted in a cumulative other comprehensive loss of \$12.2 million on the Company's balance sheet at December 31, 2005.

The Company expects to realize its deferred tax assets through tax deductions against future taxable income or carry back against taxes previously paid.

Inflation's effect 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 which would result from the slower recognition of increased costs when other methods are used. The use of historical cost depreciation has a beneficial effect on cost of products sold. The Company's results continue to be adversely affected by the significant inflation in the cost of certain commodities, particularly titanium, steel, and utilities.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS CONTINUED

Adjustments to Critical Accounting Policies

The Company has not made any adjustments to its critical accounting estimates and assumptions described in the Company's Annual Report on Form 10-K filed on May 1, 2006, or the judgment affecting the application of those estimates and assumptions.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes-an Interpretation of SFAS No. 109, which clarifies the accounting for uncertainty in tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit. The provisions of FIN 48 are effective for the Company as of January 1, 2007. The adoption of FIN 48 is not expected to have a material effect on the Company.

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 United States Treasury instruments with short-term (less than one year) maturities. 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

The Company's management, with the participation of the Company's Interim Chief Executive Officer and Treasurer and Chief Financial Officer, has evaluated the effectiveness of the Company's 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 end of the period covered by this report.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED**

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

As of December 31, 2005, the Company did not maintain sufficient controls over the calculation of the LIFO index. This control deficiency resulted in an audit adjustment to the LIFO reserve and cost of sales as of and for the year ended December 31, 2005. Additionally, this control deficiency resulted in the restatement of the financial statements as of and for the year ended December 31, 2004. Also, this control deficiency could result in a misstatement of the aforementioned account balances or disclosures which could cause a material misstatement of annual or interim financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constituted a material weakness.

**Conclusions**

Because of this material weakness, management concluded that the Company did not maintain effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control - Integrated Framework issued by the COSO. However, in the first quarter of 2006, the Company remediated the aforementioned material weakness in the Company's internal control over financial reporting. Specifically, the Company has implemented additional procedures related to the review of data used in the LIFO index calculation.

Based on their evaluation, the Company's Interim Chief Executive Officer and Treasurer and Chief Financial Officer have concluded that, as of June 30, 2006, the Company's disclosure controls and procedures are effective.

Except as noted above, 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.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

The Company has reported all cases instituted against it through March 31, 2006, 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 ended June 30, 2006.

During the three months ending June 30, 2006, no previously reported cases were settled.

On April 20, 2006, in the previously reported Fore case, the claims against the Company were dismissed by stipulation of both parties. The product in question was not manufactured by the Company.

**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, 2005.

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

Not applicable

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable

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

The 2006 Annual Meeting of the Stockholders of the Company was held on May 24, 2006. The table below sets forth the results of the votes taken at the 2006 Annual Meeting:

|    |  |               |                |
|----|--|---------------|----------------|
| 1. | Election of Directors  | Votes For     | Votes Withheld |
|    | James E. Service   | 18,808,661    | 6,084,246      |
|    | Stephen L. Sanetti   | 19,077,057    | 5,815,850      |
|    | John M. Kingsley, Jr.  | 17,656,515    | 7,236,392      |
|    | Richard T. Cunniff   | 18,806,452    | 6,086,455      |
|    | John A. Cosentino, Jr.                                       | 18,823,970    | 6,068,937      |
|    |  |               |                |
| 2. | Ratification of McGladrey & Pullen, LLP as Auditors for 2006 |               |                |
|    | Votes For  | Votes Against | Abstain        |
|    | 19,554,122   | 182,891       | 5,155,894      |

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

(a) Exhibits:

- 31.1 Certification Pursuant to Rule 13a-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification Pursuant to Rule 13a-14(a) as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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STURM, RUGER & COMPANY, INC.  
FORM 10-Q FOR THE THREE MONTHS ENDED JUNE 30, 2006  
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: August 4, 2006

S/THOMAS A. DINEEN

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

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