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# Sturm, Ruger & Co and the U.S. Firearms Industry

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# ROBINS

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## **Sturm, Ruger & Co and the U.S. Firearms Industry**

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Christopher J. Killoy was named President and Chief Executive Officer of Sturm, Ruger & Company in May of 2017. He was tasked with establishing direction as firearm demand continued to slow following a record breaking increase in gun sales.<sup>1</sup> The significant spike in 2016, a presidential election year, was at least partly the result of consumer fears that a Hillary Clinton presidency would result in stronger gun regulation.<sup>2</sup>

Bad news and regulatory threats tend to serve as positive influences for the highly volatile U.S. gun and ammunition manufacturing industry.<sup>3</sup> Calls for increased gun control measures drive Americans to purchase weapons based on concerns that the federal government might further limit Second Amendment rights.<sup>4</sup> In addition, terrorism and high-profile mass shootings also tend to increase gun purchases, as Americans remain concerned with their personal safety, as well as the looming potential for new regulations that could ultimately restrict their personal freedoms.<sup>5</sup>

Given that Ruger operates in an industry characterized by random and significant swings, how can Killoy develop a strategy that will help the company both navigate and thrive in this volatile environment?

### **BILL RUGER: A MAN WITH A PASSION**

Bill Ruger, co-founder of Sturm, Ruger & Company, Inc., had a passion for firearms that was ignited when his father gave him his first rifle on his twelfth birthday. In high school, Ruger joined the rifle team and spent much of his free time reading books on firearms and disassembling guns, just so he could learn more about how they operated. At age 22, he dropped out of college with two years remaining and accepted an offer from the United States Government to be a machine gun designer. The salary was not enough to support his family, so he left after only months on the job.

With World War II on the horizon, the U.S. Army was looking to replace its machine gun. Consequently, it published specific requirements which Ruger himself used to build a prototype. When he could not find a manufacturer that was willing to produce his design, he decided to join Auto-Ordnance Corporation, a firearms manufacturer with multiple government contracts. During Ruger's four years with the company, he learned valuable mass production manufacturing techniques and realized the importance of product innovation for stimulating demand and gaining a competitive advantage over competitors.

In 1946, Ruger left Auto-Ordnance to start The Ruger Corporation – a venture through which he hoped to accomplish three things: (1) supply parts to the firearms industry; (2) develop a hardware tool line; and (3) produce an automatic pistol. Unfortunately, this venture did not go as planned. A short three years later, the company went bankrupt. Through this failure, Ruger learned a valuable lesson that shaped the future of Sturm, Ruger & Company: when you borrow money, it is much easier to fail than if you have no debt at all.

In 1949, Ruger met firearms enthusiast Alexander Sturm, a Yale graduate from an affluent family. Together, they founded Sturm, Ruger & Company, Inc. to manufacture the automatic pistol that Ruger had intended to produce in his failed company. The company was seeded with

a \$50,000 investment that came from Sturm, and with Ruger’s new “no borrowing” policy, the company has no long-term debt to this day.

In 1951, Sturm died of hepatitis, so Ruger went on to run the company by himself. Ruger was known for his high level of integrity and frugal mentality. Rather than splurging on fancy offices, he would pay out dividends to his shareholders because he believed that they had better uses for the cash than he had. Ruger was extremely motivated by his passion for firearms, and that passion transformed the company from its humble beginnings in 1949 to generating over \$200 million in sales by the time Ruger retired in 2000.<sup>6</sup>

## COMPANY OVERVIEW

Today, Sturm, Ruger & Company (“Ruger”) is principally engaged in the design, manufacture, and sale of firearms to domestic customers. Since 1990, Ruger has been publicly traded on the New York Stock Exchange under the stock ticker RGR. The company operates with two distinct business segments: Firearms and Investment Castings. The Firearms segment offers products in three industry product categories: rifles, pistols, and revolvers. There are several available models within each product category, each of which vary based on caliber, finish, barrel length, and other features. Under the Investment Casting segment, the company manufactures and sells investment castings made from steel alloys and metal injection molding parts for internal use in the firearms segment, with minimal sales to outside customers. In 2016, investment castings represented merely 1% of total sales. The majority of Ruger sales are domestic, with exports accounting for only 3%. As of 2017, Ruger employed approximately 2,110 full-time employees. In addition to the full-time employees, Ruger employed roughly 320 temporary employees to supplement its workforce.<sup>7</sup>

### Vision

From its start in 1949, Ruger has lived up to its motto of being an “arms maker for responsible citizens”<sup>8</sup> and has strived to achieve its vision:

*“Sturm, Ruger & Co., Inc. is one of the nation’s leading manufacturers of rugged, reliable firearms for the commercial sporting market. The only full-line manufacturer of American-made firearms, Ruger offers consumers over 400 variations of more than 30 product lines. For more than 60 years, Ruger has been a model of corporate and community responsibility.”<sup>9</sup>*

Consistent with its emphasis on community responsibility, many advertisements focus on the importance of being a safe gun owner, while safety messages are posted on the Ruger website. Ruger believes in and invests in educational programs emphasizing safe gun ownership and gun use, knowing that this education has the potential to save lives.<sup>10</sup> The company has dedicated materials and other resources to the promotion of gun safety to all gun owners, including through youth programs. Each Ruger gun is designed with safety in mind by incorporating both internal and external safety measures. Recently, Ruger partnered with Project HomeSafe to deliver gun safety materials and cable locks to inner city gun owners who may not otherwise have access to the needed gun safety materials.<sup>11</sup> However, these types of programs are sometimes met with

skepticism. As Ruger has stated in its Ruger Red Book—Firearms Ownership in America—Our Responsibility for the Future:

*“Firearms safety education can and has demonstrably reduced needless accidents with firearms, particularly among younger persons. Yet, any suggestion of such a widespread educational program is immediately met with the response that it is actually ‘promoting guns.’ If we took this attitude toward sex and drug education programs, we would be accused of being naïve and immature.”<sup>12</sup>*

## **Management**

Ruger has a very seasoned and talented top management team. Ruger’s CEO, Christopher Killoy, was previously the President and Chief Operating Officer of Ruger, and has been employed by Ruger in some capacity since 2006. Killoy was also involved in the gun and ammunition manufacturing field before joining Ruger, as the Vice President of Sales and Marketing at Smith & Wesson. Killoy offers experience to Ruger, both as a seasoned veteran in the gun and ammunition manufacturing business, as well as through his membership on the Board of Directors of the Sporting Arms and Ammunition Manufacturing Institute and the International Hunter Education Association Foundation. Killoy served in the United States Army Armor division.

Mark Lang has served as Ruger’s Group Vice President since February 18, 2008. He arrived with considerable business experience, having previously served as the President of the Custom Products Division for Mueller Industries, as well as a manufacturing executive with Thomas & Betts, Black & Decker, and General Electric.

Thomas Dineen has a longstanding history with the company, joining Ruger in 1997 as a Manager of Corporate Accounting. He worked as an Assistant Controller from 2001-2003 before being promoted to Treasurer and CFO in 2003. Dineen was promoted to Vice President and CFO on May 24, 2006.

Thomas Sullivan was hired as the Vice President of Newport and Mayodan Operations and Pine Tree Castings on August 14, 2006 after previously serving as the Manufacturing Executive at IMI Norgren, Rexnord, and TRW Automotive. Sullivan brings extensive knowledge of supply chain operations, manufacturing, and product development to Ruger. He has demonstrated a continued dedication to education as a student and teacher of the Toyota Production System for the last fifteen years.

Kevin Reid started with Ruger in July 2001 as Assistant General Counsel. From there he was promoted to Director of Marketing in June of 2007. As the Director of Marketing, Reid not only oversaw daily marketing activities, but he also successfully led two highly anticipated product launches. On April 23, 2008 the Board of Directors elected Reid to serve in his current position of Vice President and General Counsel. Reid served in the United States Marine Corps from 1980-1984.

Shawn Leska has a longstanding history with Ruger, starting with the company in 1989 as an Accounting Office Assistant. He climbed the ranks of the organization and was promoted to Director of Sales in November of 2011. As Director of Sales he worked through several new product launches and was involved in sales programs and corporate initiatives. In his twenty-nine years with Ruger, Leska has developed strong industry relationships.<sup>13</sup>

Background information for the Ruger Board of Directors is included in Exhibit 1.

## **Operations**

Sturm, Ruger & Co. is headquartered in Southport, Connecticut, and maintains manufacturing facilities in Newport (New Hampshire), Prescott (Arizona), Mayodan (North Carolina), and Earth City, Missouri. The Newport facility is the largest, at 350,000 square feet, and is the only facility that manufactures both firearms and castings. The Prescott and Mayodan facilities sit at 230,000 and 220,000 square feet respectively and manufacture only firearms. Finally, the Earth City facility is the smallest, with only 35,000 square feet, and manufactures only castings.<sup>14</sup>

Historically speaking, new product introductions do not tend to cannibalize demand for existing products in this industry. Often, with the launch of a new product, the demand for mature products tends to grow as well. As a result, machines are not freed up and additional manufacturing space is ultimately required.<sup>15</sup> Consequently, with the surge in sales from 2013-2016, several manufacturers, including Ruger, tried to increase their facilities and production capabilities to account for the industry growth. Once President Trump took office, facility expansion efforts stopped.<sup>16</sup>

Ruger is very strategic about its manufacturing facility locations. For a city to qualify as a potential location candidate, it must contain abundant electrical supply, good transportation, a good workforce in the community, numerous available engineers with strong manufacturing skills, and a building with space for future expansion. If these requirements are all fulfilled, Ruger then evaluates the city's crime and drug-use rates because all employees are required to pass a federal background check.<sup>17</sup>

Gun manufacture is similar to the manufacture of other metal products with moving parts that require precision machining and assembly.<sup>18</sup> A typical gun contains between 50 and 100 parts. The precision parts are made from raw steel shapes using expensive computer-controlled machining stations.<sup>19</sup> Third parties supply Ruger with various raw materials for its firearms and castings. These materials include things such as fabricated steel components, walnut, birch, beech, maple and laminated lumber for rifle stocks, wax, ceramic material, metal alloys, various synthetic products, and other component parts. Given the limited supply of these raw materials in the marketplace, the purchase prices tend to fluctuate based on a number of market factors.<sup>20</sup> Parts are assembled and finished by hand (sometimes with elaborate metal etching or other design work), and weapons are individually test-fired.<sup>21</sup>

## Research and Development

Innovation and new products drive demand for Ruger firearms. Bill Ruger was a big proponent of innovation and made it a priority for his company. While he was CEO, he made guns that he wanted to shoot, overseeing every design detail. In 1981, he stated, “If I really personally like it, then I can be fairly sure and positive that there will be a lot of other people who feel the same way.”<sup>22</sup> To this day, the company remains focused on R&D efforts, hiring the best engineers and dedicating 141 employees towards R&D efforts.<sup>23</sup> In 2016, 2015, and 2014, the Company spent approximately \$8.7 million, \$8.5 million, and \$10.0 million, respectively, on research and development activities related to new products and to the improvement of existing products. About 30% of firearm sales are driven by new products, defined as those products having been in the market for less than two years.<sup>24</sup>

## Marketing

Ruger is known for providing high quality products at low prices. In the early years of the company’s history, Bill Ruger recognized that the company did not have the kind of brand name that some of its competitors had, so Ruger was forced to figure out a way to produce high quality firearms at a lower cost. That is when he implemented the precision investment casting technique, which allowed for the production of castings out of the highest strength alloys available at a reasonable cost. As a result of this technique, Ruger had the highest margins in the industry, which helped keep prices low.<sup>25</sup> The company still prices a number of its products modestly, such as its SR1911 Lightweight Commander Style Pistol and its LCP II, which in turn offers consumers more value at a better price.<sup>26</sup>

Ruger’s products have an excellent reputations, exemplified by the fact that the company has been given the Firearms Manufacturer of the Year award by the National Association of Sporting Goods Wholesalers for eleven straight years.<sup>27</sup> The company supports this reputation by advertising through a number of channels, including magazines, online advertising, and trade shows.<sup>28</sup> Ruger also uses promotional marketing tactics to create special relationships with its dealers. One example of this is the “Rapid Retail Rewards Program,” also known as the “4R Program.” This program awards points to dealers who sell Ruger guns. Those points can then be redeemed for free Ruger firearms. Thus, the program helps keep dealers satisfied while also increasing sales and gaining more exposure for Ruger products.<sup>29</sup>

Ruger firearms are primarily sold through a network of federally licensed, independent wholesale distributors who purchase the products directly from Ruger and then resell them to federally licensed, independent retail firearms dealers. Each distributor carries the entire line of firearms manufactured by Ruger for the commercial market. Currently, 18 distributors service the domestic commercial market, with an additional 23 distributors servicing the domestic law enforcement market, and 41 distributors servicing the export market. In 2016, Ruger’s 4 largest distributors accounted for 65% of total sales: Davidson’s (19%); Lipsey’s (17%); Jerry’s/Ellett Brothers (15%); and Sports South (14%).<sup>30</sup>



Civilians purchase firearms through gun stores, sporting goods stores, individual sellers, and some large retail stores. Ruger's website is also an important avenue through which customers can familiarize themselves with guns, although regulations restrict how individuals can purchase firearms online. An individual can buy a gun online from a federal firearms license holder. The license holder then ships the gun to a licensed dealer, and the consumer has to go directly to the dealer for a background check before picking up the gun.<sup>31</sup>

Ruger performs a semi-monthly review of the estimated sell-through from the independent distributors to retailers, as well as of the inventory levels in its warehouses and in the warehouses of its independent distributors. These reviews allow the company to better plan production levels and appropriately manage inventory levels. Computer systems are used for the extensive documentation required to track each individual gun.<sup>32</sup> Ruger aims to turn its inventory six to eight times per year. Despite a tough second quarter in 2017, Ruger was still able to turn inventory five and a half times.<sup>33</sup>

### **Human Resources**

Ruger's training programs for employees vary depending on the type of employment. In 2011, the company implemented the Ruger Code of Ethics, which provides the Board, management, and employees with the necessary tools needed to comply with industry standards.<sup>34</sup> Additionally, the Code helps create a workplace that promotes accountability among its employees and ensures that Ruger is holding itself accountable to its customers.<sup>35</sup> The company's employees participate in a profit sharing plan and bonuses are awarded to employees based on the company's financial success.<sup>36</sup> The company actively recruits individuals via the employment page on its website and continuously posts new openings available in each of the company's facilities.<sup>37</sup>

### **Financial Condition**

Over the last five years, overall revenue for Ruger has been choppy.<sup>38</sup> For example, revenue decreased in 2015 to \$551 million dollars, followed by a subsequent increase to \$664 million dollars in 2016.<sup>39</sup> Total current assets have been steadily increasing over the past five years, while total current liabilities have remained relatively constant.<sup>40</sup> Ruger's cash and short term investments have experienced a major increase in the last three years, increasing from a little less than \$9 million in 2014 to \$87 million in 2016.<sup>41</sup> Ruger's Q3 2017 financial results indicate that the company is not meeting Wall Street expectations for its earnings per share and sales.<sup>42</sup> Ruger's operating profit margin in 2016 was 20.4%.<sup>43</sup> Exhibits 2 and 3 contain detailed financial information.

## **THE U.S. GUN AND AMMUNITION INDUSTRY**

The U.S. gun and ammunition manufacturing industry has over \$13 billion in annual revenues. Approximately half of that revenue is generated by the top seven domestic manufacturers, which include American Outdoor Brands, Colt, National Presto, Remington Outdoor, Vista Outdoor, Sig Sauer, and Ruger. Products include ammunition and firearms such as shotguns, rifles, revolvers, pistols, and machine guns. Demand is driven mostly by hunters, gun enthusiasts, and

weapon upgrades by law enforcement.<sup>44</sup> Profitability is closely linked to marketing efforts made by individual companies.<sup>45</sup> The industry is costly to compete in due to high initial investment costs, considerable research and development costs, and high machine operation costs. Large companies benefit from purchasing economies when they acquire materials from suppliers.<sup>46</sup> However, small companies can effectively compete by producing premium-priced, high-quality, or decorative guns.<sup>47</sup> The three major market segments within the guns and ammunition manufacturing industry include civilians and law enforcement, the military, and exports.<sup>48</sup>

Growth in the U.S. gun industry was stagnant from 2012 to 2017. Even so, some analysts expect the industry to grow 3.5% annually from 2017 to 2022. Defense spending and increased legislation are predicted to have a major impact on the growth of the industry over the next five years.<sup>49</sup> However, there is so much volatility in the industry that trends are hard to predict.

### **Close Rival American Outdoor Brands Corporation**

In many ways, American Outdoor Brands Corporation (AOBC – FY Sales of \$903 M) is Ruger’s closest rival. It is a domestic gun manufacturer that sells nearly the same number of firearms as Ruger, has a similar balance in sales between handguns and long guns, and many of its weapons compete head-to-head through the same retailer channels. AOBC grew from a single firearms operating division founded in 1852 under the widely known Smith & Wesson brand to multiple operating divisions and consumer brands today. AOBC now serves as the holding company for the historic Smith & Wesson Corp., Battenfeld Technologies, Inc., and Crimson Trace Corporation, which represent firearms, manufacturing services, accessories, and electro-optics divisions. AOBC operates in two business segments: (1) Firearms (which includes the Firearms and Manufacturing Services divisions) and (2) Outdoor Products & Accessories (which includes Accessories and Electro-Optics divisions).<sup>50</sup> The firearms division, which accounted for roughly 95% of revenues for FY 2017, produces and sells handguns (pistols and revolvers) and long guns (rifles).<sup>51</sup> AOBC has added to its growth through several acquisitions in the past few years, including \$211.1 million in acquisitions in 2016/2017.<sup>52</sup> Annual revenue increased by 25-30% each year from 2015-2017, and net income grew from \$49.6 million in 2015 to \$127.8 million in 2017.<sup>53</sup>

AOBC’s mission is: “To leverage our employees’ capabilities and experiences to design, produce, and market high quality, innovative firearms, accessories, and outdoor products that meet the needs and desires of our consumer and professional customers while delivering a healthy financial performance. The company’s vision is: “To be the leading provider of quality products for the shooting, hunting, and rugged outdoor enthusiast.”

Like Ruger, AOBC has a strong emphasis on innovation. The company releases new products every few years with new features and technology. This keeps consumers excited for new opportunities to enhance their firearms collections. Following the successful launch of the M&P Shield pistol in 2012, AOBC launched the M&P 2.0 Pistol in 2017. This new product has an upgraded trigger, grip and frame from the popular M&P Pistol used by many law enforcement agencies today.<sup>54</sup> Their two main production plants in Springfield, Massachusetts and Houlton, Maine have sometimes become strained during high demand periods, leading to huge backlogs.<sup>55</sup> In May of 2014, then Smith and Wesson acquired Tri Town Precision Plastics, a previous

supplier of polymer molding and prototyping for their products.<sup>56</sup> Once acquired, the new operating name became Deep River Plastics, LLC. The acquisition helped ease capacity problems by significantly shortening the time it took the company to get materials from Tri Town and provided an additional 150,000 square foot production facility to be used to increase production capacity.

In the U.S., five prominent arms distributors account for most of AOBC's sales. The company also sells firearms directly to law enforcement agencies. In addition, a significant portion of its firearms are sold overseas, mainly through commercial distributors.<sup>57</sup> In 2017, AOBC announced that it had decided to streamline and standardize its distribution process. The company plans to create a Logistics and Customer Service Division that will operate from a new 500,000 square foot distribution center in Missouri. The center will be equipped with latest technology, which will help to improve their operating efficiency by serving as a central distribution center.<sup>58</sup>

### **Other Significant Competitors**

Remington Outdoor Company (2016 Sales of \$865 M), founded in 1816, is the oldest firearms manufacturer in the US. The firm is well known for manufacturing rifles and shotguns, as well as ammunition. Remington is the market leader in long guns with a 15.8% market share in the domestic rifle market in 2014.<sup>59</sup> While the firm was not active in the handgun market for most of its existence, it entered this segment in 2010 with the R1 1911. The company believes this is an area of opportunity, as the handgun market continues to grow. Finally, Remington is a major player in the ammunition market, with three major brands under the firm's umbrella. Remington has two major strategic initiatives to sustain growth in the future. The first is to focus on new product development, specifically in the handgun segment. The firm recognizes the growing market opportunity with handguns and is committed to cutting into the market share of Sturm Ruger and American Outdoor Brands. With new product development, the firm has invested \$180 Million to increase operational capacity and efficiency.<sup>60</sup> Finally, Remington hopes to tap into the domestic and international law enforcement and military defense markets.

In addition to Remington, a few other competitors are noteworthy. Vista Outdoor Operations (FY 2017 sales of \$2.5 B) has outdoor sports (i.e., outdoor cooking equipment, eyewear, paddleboards) and shooting sports business segments.<sup>61</sup> Vista's shooting sports segment, which accounts for a little over half of its sales, produces firearms such as centerfire rifles, rimfire rifles, shotguns, and range systems.<sup>62</sup> Vista sells to civilians, law enforcement agencies, the government, and international markets.<sup>63</sup> Its Federal Premium ammunition brand is number one in market share in the ammunition segment. Sig Sauer, Inc. (est. recent sales of \$305 M) makes and imports handguns and firearms accessories, and also sells apparel and knives. The company is the largest member of a worldwide business group of firearms manufacturers.<sup>64</sup>

Also, smaller competitor Colt Defense (est. recent sales of \$54 M) is an American firearms manufacturer that designs, develops and manufactures handguns, long guns, and other firearms for international military, law enforcement, and individual domestic consumers.<sup>65</sup> In addition, National Presto Industries (2016 sales of \$342 M), is primarily a housewares and electrical appliance company. However, in 2001, the company purchased AMTEC, which allowed it to enter the defense segment. This segment "manufactures precision mechanical and

electromechanical assemblies for the U.S. Government and prime contractors.”<sup>66</sup> In addition, numerous companies compete in the U.S. with very inexpensive firearms. For example, Cobra Enterprises, based in Utah, and Hi-Point Firearms (Strassell’s Machine, Inc.) manufacture handguns that can sell for less than \$200.

No discussion of gun industry competition would be complete without mentioning international competitors that sell their products in the U.S. Glock is chief among these competitors in the handgun segment. Glock, Inc., based in Smyrna, Georgia, operates as a subsidiary of GLOCK Ges.m.b.H of Austria. The company has been very successful in the law enforcement and military segments in the U.S., and sells its products commercially. Other international companies with significant gun sales in the U.S. include Beretta (Italy) and Taurus International (Brazil).

### **The National Rifle Association**

The U.S. gun and ammunition industry has a very powerful political ally in the National Rifle Association (“NRA”). The NRA was established in 1875 with the purpose to “promote and encourage rifle shooting on a scientific basis.” It has since grown to be an organization focused on training, education, and marksmanship. In 1975, recognizing the great need to defend the second amendment through political action, NRA established the Institute of Legislative Action (ILA) to lobby legislators and engage members for political action. The NRA has grown to have more than five million members in 2017, and it actively engages its members by calling them to action every time a piece of restrictive “gun control” legislation is proposed at the local, state, or federal level.<sup>67</sup> Since its establishment, the NRA has had a great influence on American gun laws and policies. CBS News reported in 2016 that from 2011-2016, there were more than 100 gun control proposals introduced by lawmakers. However, due to the lobbying efforts of NRA members, none of those passed, and only a few were brought to the house and senate floor.<sup>68</sup> In addition, when a gun tragedy occurs, the NRA quickly releases a statement in an effort to promote pro-firearm interests.<sup>69</sup>

The NRA is very active during presidential campaigns, contributing to the campaigns of candidates that support expanded gun rights and targeting those who threaten to control or regulate guns.<sup>70</sup> In the 2016 election, the group threw its support behind President Donald Trump, and against Democratic opponent Hillary Clinton.<sup>71</sup> Nevertheless, its political power is greater at the state level than the federal level. It uses a “grading system” to grade each politician on their willingness to support NRA causes, and the NRA uses those “grades” to help determine the best candidate to represent the Republican party in state elections.<sup>72</sup>

Any firm in the industry that chooses to cross the NRA does so at its own peril. Smith & Wesson (now AOBC) learned this the hard way. Starting in 1998, cities and counties around the USA, fueled by the momentum of earlier legal suits against cigarette makers, filed suits against gun makers. Smith & Wesson was hit with lawsuits by over 28 cities, suing it for damages caused by gun violence. In response to these suits, Ed Schultz, Smith & Wesson’s CEO at that time, met with the Clinton Administration, and settled on an agreement that would further regulate and control the way it manufactures firearms. As part of the agreement, Smith & Wesson agreed, amongst other things, to include a second hidden serial number on its firearms to offset the tendency for criminals to scratch out the number, to include a small lock in each gun that would

prevent the trigger from being pulled, and to develop a “smart-gun technology” by 2003 that would allow handguns to be fired only by authorized users. The NRA did not like the new agreement, and sought to mobilize its members to boycott Smith & Wesson products. That same year, Smith & Wesson suffered a decrease in sales by 40%, causing it to lay off 15% of its workforce, and subsequently replacing its CEO. By 2001 things were so bad at Smith & Wesson that it was sold by its parent company, Tomkins PLC, for a mere \$15 million.<sup>73</sup> The company then sought to, and was successful in, regaining a prominent position in the U.S. gun industry. They did so, in part, by publicly rejecting the terms of the Clinton gun safety agreement and coming up with a new line of high-capacity pistols and an assault-style rifle, the first of its kind for the company. These new products became best sellers, and the Bush administration also helped by awarding Smith & Wesson with several new federal contracts.<sup>74</sup>

### **Social and Political Forces**

The gun industry in the U.S. is subject to state and federal regulations. Most federal regulations are implemented through the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF). All manufacturers, dealers, and retailers must have a federal license in order to participate in the industry. Prospective buyers are subject to point-of-sale background checks, and those with criminal records or any other disqualifying factors are restricted from making a purchase. Some state and municipal governments have gun laws that are stricter than federal laws. Such laws may prohibit entire classes of firearms, ammunition, or ammunition magazines from being sold in the respective governing area. Gun manufacturers are also subject to state and federal laws and regulations regarding the use, storage, and disposal of hazardous materials.<sup>75</sup>

In today’s political climate, there is a lot of talk about gun violence, gun control and individual rights. The NRA has done well informing Americans of their Second Amendment right to bear arms. The media has done a terrific job of highlighting recent gun violence, mass shootings, and terrorist attacks to motivate Americans in two different ways. Some view these stories and desire personal protection, and are subsequently motivated to purchase a gun. Others view the same story and call for a lock-down on gun purchasing and stricter gun regulations. The media has continuously highlighted these types of stories, resulting in many Americans believing that gun violence has escalated in the U.S. In fact, gun violence dropped significantly from the 1990s to the early 2000s and has remained more or less stable since 2005.<sup>76</sup> On the other hand, it is still a serious problem. Data from the U.S. Centers for Disease Control and Prevention (CDC) show that on an average day, 93 Americans are killed with firearms.<sup>77</sup>

Two very significant pieces of legislation have influenced the U.S. gun industry. In September 1994, a Federal Assault Weapons Ban (AWB) went into effect, which prohibited the manufacture, transfer, and possession of certain assault weapons and all large capacity magazines (LCMs), but the law expired in 2004.<sup>78</sup> Since then, assault-style weapons and LCMs are common characteristics of guns discussed in policy debates because they are disproportionately used in mass shootings.<sup>79</sup> For instance, the suspect in the mass shooting at a movie theater in Aurora, Colorado used an assault rifle with a 100-round magazine. Similar weapons were used in the mass shootings at Virginia Tech University and Fort Hood, Texas. The deadliest mass shooting by an individual in U.S. history occurred in October 2017 when the shooter used a bump-fire stock to make a semiautomatic weapon perform like a machine gun.<sup>11</sup>

The shooting prompted support in the U.S. Congress for legislation that would ban bump fire stocks and the National Rifle Association (NRA) supported these regulations.<sup>80</sup> In November 2017, Massachusetts became the first state to ban the sale, possession, or use of such devices.<sup>81</sup>

In October 2005, Congress passed the Protection of Lawful Commerce in Arms Act (PLCAA), which was put in place to protect firearm manufacturers from being held liable when crimes have been committed with their products.<sup>82</sup> The firearms industry has successfully defended numerous civil action lawsuits from gun violence victims due to this federal law. For instance, in October 2016, a Connecticut superior court judge dismissed a lawsuit filed by the families of victims of the 2012 Sandy Hook Elementary School shooting against a firearm company. However, in November 2017, families of victims appealed to the Connecticut Supreme Court, which will now decide if the families' claims can proceed. This case will be a test of the federal law, which protects firearms manufacturers from liability claims.<sup>83</sup> If this law is repealed or changed, then arms manufacturers may have to allocate substantial financial resources to fight and settle such claims.<sup>84</sup>

### **MOVING FORWARD**

Killoy and Ruger face significant challenges and uncertainty. Gun violence has the potential to restrict possession of guns in the U.S.; however, consumer fears of firearm bans and stricter gun control measures actually lead many consumers to purchase firearms.<sup>85</sup> Competition is fierce from domestic manufacturers and imports, and cheap gun manufacturers are cutting into the market share of the high-quality manufacturers. The balance of power between the typically anti-regulation Republicans and pro-regulation Democrats could change with any national election.

How can Ruger continue to compete well against its rivals, both domestic and foreign? Should the company diversify to hedge its risks? If so, into what business or businesses, and how should it enter? Should Ruger take a serious look at international expansion? If the company makes changes that will require significant resources, is it time to consider some long-term debt? Or perhaps the company should just wait a while before making changes to see what happens with regulation.

## EXHIBIT 1: STURM, RUGER & CO., INC. BOARD OF DIRECTORS

**C. Michael Jacobi, Chairman** - Mr. Jacobi has served on the Board since June of 2006. He is President of Stable House 1, LLC, a private company that specializes in real estate development. Jacobi is a Certified Public Accountant and brings considerable audit experience to the Board of Directors.

**John A. Cosentino, Jr., Vice Chairman** - Mr. Casentino is a founding partner of the Ironwood Manufacturing Fund and has served on the Board since August, 2005. He has considerable experience as a manufacturing executive and leading several private investments.

**Michael O. Fifer** - Mr. Fifer served as the CEO from September, 2006 to May, 2017 and has been an active member of the Board since 2006. He possesses considerable industry experience from his tenure. Fifer earned a BS in Physics from the United States Naval Academy, an MBA from Harvard Business School, and served as a submarine officer in the United States Navy.

**Sandra S. Froman** - Ms. Froman has been an active member of the National Rifle Association since 1992. She served as Vice President from 1998 to 2005 and as President of the NRA from 2005-2007. Ms. Froman has a BS in Economics from Stanford University and a JD from Harvard Law School. She currently practices as a private civil attorney for her own firm.

**Terrence G. O'Connor** - Mr. O'Connor joined the Board with considerable financial and audit experience. He currently serves on the Nominating and Corporate Governance Committee and helps drive strategy for Ruger as a member of the Risk Oversight Committee. He received a Mechanical Engineering degree from the Imperial College in London.

**Amir P. Rosenthal** - Mr. Rosenthal has been on the Board since 2010. He was Chief Financial Officer of Performance Sports Group, LTD. for seven years and is a current Director at Ruger.

**Ronald C. Whitaker** - Mr. Whitaker has served on the Board since 2006. He retired from Hyco International after serving as the organization's CEO from 2003-2011.

**Phillip C. Widman** - Mr. Widman is a current director at Ruger and has served on the Board since January of 2010. His experience includes years of financial roles, CFO of Philip Service Corporation, and work as an independent consultant.

Source: Sturm, Ruger & Company, Inc. Board of directors & corporate officers.  
<http://ruger.com/corporate/BOD.html>. Accessed November 30, 2017

## EXHIBIT 2: STURM, RUGER & COMPANY INCOME STATEMENTS

Consolidated Statements of Income and Comprehensive Income  
(In thousands, except per share data)

<i>Year ended December 31,</i>	<b>2016</b>	2015	2014
Net firearms sales	\$658,433	\$544,850	\$542,267
Net castings sales	5,895	6,244	2,207
Total net sales	664,328	551,094	544,474
Cost of products sold	444,774	378,934	375,300
Gross profit	219,554	172,160	169,174
Operating Expenses:			
Selling	56,146	49,864	44,550
General and administrative	29,004	27,864	28,899
Defined benefit pension plans settlement charge	-	-	40,999
Other operating income, net	(5)	(113)	(1,612)
Total operating expenses	85,145	77,615	112,836
Operating income	134,409	94,545	56,338
Other income:			
Royalty income	1,142	1,084	468
Interest income	14	5	2
Interest expense	(186)	(156)	(152)
Other income (expense), net	542	622	584
Total other income, net	1,512	1,555	902
Income before income taxes	135,921	96,100	57,240
Income taxes	48,449	33,974	18,612
Net income and comprehensive income	\$ 87,472	\$ 62,126	\$ 38,628
Basic Earnings Per Share	\$4.62	\$3.32	\$1.99
Diluted Earnings Per Share	\$4.59	\$3.21	\$1.95
Cash Dividends Per Share	\$1.73	\$1.10	\$1.62

Source: Sturm, Ruger & Company, Inc. 2016. **Form 10-K**. Southport, CT: Sturm, Ruger & Company, Inc: 52.



### EXHIBIT 3: STURM, RUGER & COMPANY BALANCE SHEETS

Consolidated Balance Sheets  
*(Dollars in thousands, except per share data)*

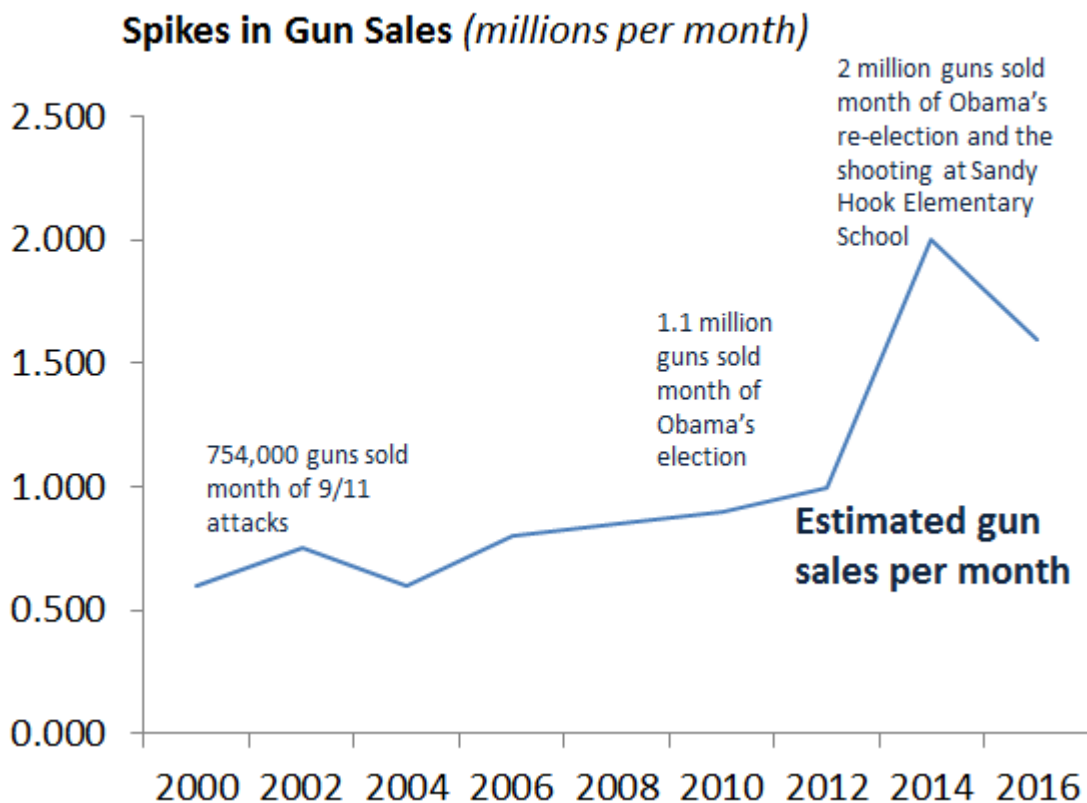
<i>December 31,</i>	<b>2016</b>	2015
<b>Assets</b>		
Current Assets		
Cash and cash equivalents	\$ 87,126	\$ 69,225
Trade receivables, net	69,442	71,721
Gross inventories	99,417	81,278
Less LIFO reserve	(42,542)	(42,061)
Less excess and obsolescence reserve	(2,340)	(2,118)
Net inventories	54,535	37,099
Deferred income taxes	8,859	8,219
Prepaid expenses and other current assets	3,660	3,008
Total Current Assets	223,622	189,272
Property, Plant, and Equipment	331,639	308,597
Less allowances for depreciation	(227,398)	(204,777)
Net property, plant and equipment	104,241	103,820
Other assets	27,541	22,791
Total Assets	\$355,404	\$315,883

*Balance sheet continued on next page...*

<i>December 31,</i>	<b>2016</b>	2015
<b>Liabilities and Stockholders' Equity</b>		
Current Liabilities		
Trade accounts payable and accrued expenses	\$ 48,493	\$ 42,991
Product liability	1,733	642
Employee compensation and benefits	25,467	28,298
Workers' compensation	5,200	5,100
Income taxes payable	-	4,962
<b>Total Current Liabilities</b>	<b>80,893</b>	<b>81,993</b>
Product liability	86	102
Deferred income taxes	8,525	6,050
Contingent liabilities (Note 17)	-	-
Stockholders' Equity		
Common stock, non-voting, par value \$1: Authorized shares – 50,000; none issued		
Common stock, par value \$1: Authorized shares – 40,000,000		
2016 – 24,034,201 issued, 18,688,511 outstanding		
2015 – 23,775,766 issued, 18,713,419 outstanding	24,034	23,776
Additional paid-in capital	27,211	29,591
Retained earnings	293,400	239,098
Less: Treasury stock – at cost		
2016 – 5,345,690 shares		
2015 – 5,062,347 shares	(78,745)	(64,727)
<b>Total Stockholders' Equity</b>	<b>265,900</b>	<b>227,738</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$355,404</b>	<b>\$315,883</b>

Source: Source: Sturm, Ruger & Company, Inc. 2016. **Form 10-K**. Southport, CT: Sturm, Ruger & Company, Inc: 50-51.

#### EXHIBIT 4: EXTERNAL INFLUENCES ON GUN SALES



Source: Aisch, G. 2016. What happens after calls for new gun restrictions? Sales go up. *The New York Times (Online)*. June 13. <https://www.nytimes.com/interactive/2015/12/10/us/gun-sales-terrorism-obama-restrictions.html>. Accessed November 30, 2017.

**EXHIBIT 5: ECONOMIC IMPACT OF THE SPORTING ARMS AND AMMUNITION  
INDUSTRY IN THE UNITED STATES**

<b>Tax Impact</b>	<b>Business Taxes</b>	<b>Excise Taxes</b>
<b>Federal Taxes</b>	\$3,843,285,200	\$838,059,600
<b>State Taxes</b>	\$2,695,451,100	
<b>Total Taxes</b>	\$6,538,736,300	\$838,059,600

	<b>Direct</b>	<b>Supplier</b>	<b>Induced</b>	<b>Total</b>
<b>Jobs (FTE)</b>	141,500	66,614	93,009	301,123
<b>Wages</b>	\$5,847,837,400	\$4,522,015,700	\$4,813,571,600	\$15,183,424,700
<b>Economic Impact</b>	\$20,223,132,100	\$15,525,775,600	\$15,502,536,200	\$51,251,443,900

Source: The Firearm Industry Trade Association, Firearms and ammunition industry economic impact report, <https://www.nssf.org/government-relations/impact/>, Accessed November 30, 2017.

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