

LAWSON PRODUCTS INC/NEW/DE/  
Form 10-Q  
October 25, 2018  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

FORM 10-Q

(Mark One)

Quarterly Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934  
For quarterly period ended September 30, 2018

or

Transition Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file Number: 0-10546

LAWSON PRODUCTS, INC.  
(Exact name of registrant as specified in its charter)

Delaware 36-2229304  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

8770 W. Bryn Mawr Avenue, Suite 900, Chicago, Illinois 60631  
(Address of principal executive offices) (Zip Code)  
(773) 304-5050  
(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 filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

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

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

The number of shares outstanding of the registrant's common stock, \$1 par value, as of October 15, 2018 was 8,919,644.

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“Safe Harbor” Statement under the Securities Litigation Reform Act of 1995:

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. The terms “may,” “should,” “could,” “anticipate,” “believe,” “continues,” “estimate,” “expect,” “intend,” “objective,” “plan,” “potential,” “project” and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. These statements are based on management’s current expectations, intentions or beliefs and are subject to a number of factors, assumptions and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include:

- the effect of general economic and market conditions;
- the ability to generate sufficient cash to fund our operating requirements;
- the ability to meet the covenant requirements of our line of credit;
- the market price of our common stock may decline;
- inventory obsolescence;
- work stoppages and other disruptions at transportation centers or shipping ports;
- changing customer demand and product mixes;
- increases in energy and commodity prices;
- decreases in demand from oil and gas customers due to lower oil prices;
- disruptions of our information and communication systems;
- cyber attacks or other information security breaches;
- failure to recruit, integrate and retain a talented workforce including productive sales representatives;
- the inability to successfully make or integrate acquisitions into the organization;
- foreign currency fluctuations
- failure to manage change within the organization;
- highly competitive market;
- changes that affect governmental and other tax-supported entities;
- violations of environmental protection or other governmental regulations;
- negative changes related to tax matters; and
- all other factors discussed in the Company’s “Risk Factors” set forth in its Annual Report on Form 10-K for the year ended December 31, 2017.

The Company undertakes no obligation to update any such factors or to publicly announce the results of any revisions to any forward-looking statements contained herein whether as a result of new information, future events or otherwise.

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## PART I - FINANCIAL INFORMATION

## ITEM 1 - FINANCIAL STATEMENTS

Lawson Products, Inc.

Condensed Consolidated Balance Sheets

(Dollars in thousands, except share data)

|  | September<br>30,<br>2018<br>(Unaudited) | December<br>31,<br>2017 |
|--|---|-------------------------|
| <b>ASSETS</b>  |   |                         |
| Current assets:  |   |                         |
| Cash and cash equivalents  | \$ 7,663                                | \$4,416                 |
| Restricted cash  | 800                                     | 800                     |
| Accounts receivable, less allowance for doubtful accounts of \$445 and \$476, respectively | 43,561                                  | 38,575                  |
| Inventories, net   | 51,154                                  | 50,928                  |
| Miscellaneous receivables and prepaid expenses   | 5,077                                   | 3,728                   |
| Total current assets   | 108,255                                 | 98,447                  |
| Property, plant and equipment, net   | 24,535                                  | 27,333                  |
| Deferred income taxes  | 20,457                                  | 21,248                  |
| Goodwill   | 19,114                                  | 19,614                  |
| Cash value of life insurance   | 13,360                                  | 11,964                  |
| Intangible assets, net   | 10,901                                  | 11,813                  |
| Other assets   | 339                                     | 248                     |
| Total assets   | \$ 196,961                              | \$ 190,667              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |   |                         |
| Current liabilities:   |   |                         |
| Revolving lines of credit  | \$ 9,918                                | \$14,543                |
| Accounts payable   | 16,332                                  | 12,394                  |
| Accrued expenses and other liabilities   | 38,583                                  | 33,040                  |
| Total current liabilities  | 64,833                                  | 59,977                  |
| Security bonus plan  | 12,876                                  | 12,981                  |
| Financing lease obligation   | 5,524                                   | 6,420                   |
| Deferred compensation  | 6,107                                   | 5,476                   |
| Deferred rent liability  | 2,081                                   | 3,512                   |
| Deferred tax liability   | 3,073                                   | 3,115                   |
| Other liabilities  | 4,445                                   | 5,696                   |
| Total liabilities  | 98,939                                  | 97,177                  |
| Stockholders' equity:  |   |                         |
| Preferred stock, \$1 par value:  |   |                         |
| Authorized - 500,000 shares, Issued and outstanding — None                                 | —                                       | —                       |
| Common stock, \$1 par value:   |   |                         |
| Authorized - 35,000,000 shares   |   |                         |
| Issued - 8,952,918 and 8,921,302 shares, respectively                                      | 8,953                                   | 8,921                   |
| Outstanding - 8,919,644 and 8,888,028 shares, respectively                                 |   |                         |
| Capital in excess of par value   | 14,989                                  | 13,005                  |

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|  |            |            |
|--|------------|------------|
| Retained earnings                          | 74,738     | 71,453     |
| Treasury stock – 33,274 shares             | (711 )     | (711 )     |
| Accumulated other comprehensive income     | 53         | 822        |
| Total stockholders' equity                 | 98,022     | 93,490     |
| Total liabilities and stockholders' equity | \$ 196,961 | \$ 190,667 |

See notes to condensed consolidated financial statements.

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Lawson Products, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(Dollars in thousands, except per share data)

(Unaudited)

|   | Three Months<br>Ended September<br>30, |          | Nine Months Ended<br>September 30, |           |
|---|--|----------|------------------------------------|-----------|
|   | 2018                                   | 2017     | 2018                               | 2017      |
| Product revenue                                 | \$78,377                               | \$75,651 | \$233,744                          | \$225,274 |
| Service revenue                                 | 10,153                                 | —        | 29,627                             | —         |
| Total revenue                                   | 88,530                                 | 75,651   | 263,371                            | 225,274   |
| Product cost of goods sold                      | 36,979                                 | 29,646   | 109,667                            | 89,249    |
| Service costs                                   | 3,443                                  | —        | 10,247                             | —         |
| Gross profit                                    | 48,108                                 | 46,005   | 143,457                            | 136,025   |
| Operating expenses:                             |  |          |                                    |           |
| Selling expenses                                | 22,175                                 | 24,354   | 66,119                             | 72,964    |
| General and administrative expenses             | 28,199                                 | 20,561   | 72,213                             | 58,790    |
| Total SG&A                                      | 50,374                                 | 44,915   | 138,332                            | 131,754   |
| Gain on sale of property                        | —                                      | —        | —                                  | (5,422 )  |
| Operating expenses                              | 50,374                                 | 44,915   | 138,332                            | 126,332   |
| Operating income (loss)                         | (2,266 )                               | 1,090    | 5,125                              | 9,693     |
| Interest expense                                | (251 )                                 | (133 )   | (755 )                             | (393 )    |
| Other income (expense), net                     | 170                                    | 843      | (320 )                             | 953       |
| Income (loss) before income taxes               | (2,347 )                               | 1,800    | 4,050                              | 10,253    |
| Income tax (benefit) expense                    | (1,531 )                               | 479      | 436                                | 802       |
| Net (loss) income                               | \$(816 )                               | \$1,321  | \$3,614                            | \$9,451   |
| Basic income (loss) per share of common stock   | \$(0.09 )                              | \$0.15   | \$0.41                             | \$1.07    |
| Diluted income (loss) per share of common stock | \$(0.09 )                              | \$0.14   | \$0.39                             | \$1.04    |
| Weighted average shares outstanding:            |  |          |                                    |           |
| Basic weighted average shares outstanding       | 8,919                                  | 8,880    | 8,904                              | 8,856     |
| Effect of dilutive securities outstanding       | —                                      | 253      | 346                                | 256       |
| Diluted weighted average shares outstanding     | 8,919                                  | 9,133    | 9,250                              | 9,112     |
| Comprehensive income (loss):                    |  |          |                                    |           |
| Net income (loss)                               | \$(816 )                               | \$1,321  | \$3,614                            | \$9,451   |
| Other comprehensive income (loss), net of tax   |  |          |                                    |           |
| Adjustment for foreign currency translation     | 692                                    | 139      | (769 )                             | 941       |
| Net comprehensive income (loss)                 | \$(124 )                               | \$1,460  | \$2,845                            | \$10,392  |

See notes to condensed consolidated financial statements.

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Lawson Products, Inc.  
Condensed Consolidated Statements of Cash Flows  
(Dollars in thousands)  
(Unaudited)

|   | Nine Months<br>Ended September<br>30, |            |
|---|---------------------------------------|------------|
|   | 2018                                  | 2017       |
| Operating activities:   |                                       |            |
| Net income  | \$3,614                               | \$9,451    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                       |            |
| Depreciation and amortization   | 5,120                                 | 4,940      |
| Stock-based compensation  | 8,694                                 | 2,722      |
| Deferred income taxes   | 830                                   | —          |
| Gain on sale of property  | —                                     | (5,422 )   |
| Changes in operating assets and liabilities:                                      |                                       |            |
| Accounts receivable   | (5,624 )                              | (7,046 )   |
| Inventories   | (566 )                                | (373 )     |
| Prepaid expenses and other assets   | (3,651 )                              | (1,562 )   |
| Accounts payable and other liabilities  | 1,315                                 | 738        |
| Other   | 442                                   | 307        |
| Net cash provided by operating activities   | 10,174                                | 3,755      |
| Investing activities:   |                                       |            |
| Purchases of property, plant and equipment  | \$(1,626)                             | \$(1,228 ) |
| Business acquisition  | (157 )                                | —          |
| Proceeds from sale of property  | —                                     | 6,177      |
| Net cash provided by (used in) investing activities                               | (1,783 )                              | 4,949      |
| Financing activities:   |                                       |            |
| Net payments from revolving lines of credit                                       | \$(4,625)                             | \$(841 )   |
| Proceeds from stock option exercises  | 14                                    | —          |
| Repurchase treasury shares  | —                                     | (20 )      |
| Net cash used in financing activities   | (4,611 )                              | (861 )     |
| Effect of exchange rate changes on cash and cash equivalents                      | (533 )                                | 779        |
| Increase in cash, cash equivalents and restricted cash                            | 3,247                                 | 8,622      |
| Cash, cash equivalents and restricted cash at beginning of period                 | 5,216                                 | 11,221     |
| Cash, cash equivalents and restricted cash at end of period                       | \$8,463                               | \$19,843   |

See notes to condensed consolidated financial statements.

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Notes to Condensed Consolidated Financial Statements

Note 1 — Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements of Lawson Products, Inc. (the “Company”) have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all disclosures required by generally accepted accounting principles. Reference should be made to the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of the Company, all normal recurring adjustments have been made that are necessary to present fairly the results of operations for the interim periods. Operating results for the three and nine month periods ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The Company has two operating segments. The first segment, the Lawson operating segment, distributes maintenance, repair and operations (“MRO”) products to customers primarily through a network of sales representatives offering vendor managed inventory (“VMI”) service to customers throughout the United States and Canada. The second segment, The Bolt Supply House Ltd. (“Bolt Supply”) operating segment, distributes MRO products primarily through its branches located in Western Canada. Bolt Supply had 13 branches in operation at the end of the third quarter 2018.

Note 2 - Revenue Recognition

Adoption of ASC 606

On January 1, 2018 the Company adopted Accounting Standards Codification 606-Revenue From Contracts With Customers (“ASC 606”). As part of the Company's adoption of ASC 606, it concluded that it has two separate performance obligations, and accordingly, two separate revenue streams: products and services. As a result, the Company is now reporting two separate revenue streams and two separate costs of revenues. The adoption of ASC 606 had a minimal impact on total reported revenues, costs and net income for the first nine months of 2018. However, the adoption required prospective reclassification of certain selling expenses associated with the separately identified vendor managed inventory services performance obligation costs historically classified as selling expenses to cost of sales. As ASC 606 was adopted on a modified retrospective method, prior quarters are not restated. Effective January 1, 2018, the Company recorded a cumulative effect adjustment in opening retained earnings in the amount of \$0.3 million based on applying the guidance to the customer contracts that were not completed on that date.

ASC 606 defines a five step process to recognize revenues at the time and in an amount that reflects the consideration expected to be received for the performance obligations that have been provided. ASC 606 defines contracts as written, oral and through customary business practice. Under this definition, the Company considers contracts to be created at the time an order to purchase product is agreed upon regardless of whether or not there is a written contract.

Performance Obligations

Lawson has two operating segments; the Lawson segment and the Bolt Supply segment. Customer contracts have the following performance obligations:

The Lawson segment has two distinct performance obligations offered to its customers: a product performance obligation and a service performance obligation. Although the Company has identified that it offers its customers both a product and a service obligation, the customer only receives one invoice per transaction with no price breakout between these obligations. The Company does not price its offerings based on any breakout between these obligations.

Lawson generates revenue primarily from the sale of MRO products to its customers. Revenue related to product sales is recognized at the time that control of the product has been transferred to the customer; either at the time the product is shipped or the time the product has been received by the customer. The Company does not commit to long-term contracts to sell customers a certain minimum quantity of products.

The Lawson segment offers a VMI service proposition to its customers. A portion of these services, primarily related to stocking of product and maintenance of the MRO inventory, is provided a short period of time after control of the purchased product has been transferred to the customer. Since some components of VMI service have not been provided at the time the control of the product transfers to the customer, that portion of expected consideration is deferred until the time that those services have been provided.

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The Bolt Supply segment does not provide VMI services for its customers or provide services in addition to product sales to customers. Revenue is recognized at the time that control of the product has been transferred to the customer which is either upon delivery or shipment depending on the terms of the contract.

## Accounting Policy Elections

The Company has elected to treat shipping and handling costs after the control of the product has been transferred to the customer as a fulfillment cost.

Sales taxes that are imposed on our sales and collected from customers are excluded from revenues.

The Company expenses sales commissions when incurred as the amortization period is one year or less.

## Significant Judgments

The Company employs certain significant judgments to estimate the dollar amount of revenue, and related expenses, allocated to the sale of product and service. These judgments include, among others, the percentage of customers that take advantage of the VMI services offered, the amount of revenue to be allocated to the VMI service based on the value of the service to its customers, and the amount of time after control of the product passes to the customer that the VMI service obligation is completed. It is assumed that any customer who averages placing orders at a frequency of longer than 30 days does not take advantage of the available VMI services offered. The estimate of the cost of sales is based on expenses directly related to sales representatives that provide direct VMI services to the customer.

## Financial Impact of ASC 606 Adoption

As a result of applying ASC 606 the Company recorded a liability of \$0.7 million for deferred revenue on January 1, 2018. Expenses related to these revenues of \$0.4 million were also deferred resulting in a net reduction to opening retained earnings of \$0.3 million as of January 1, 2018. At September 30, 2018, the Company had a deferred revenue liability of \$0.7 million and a deferred expense of \$0.3 million for related expenses associated with the deferred service performance obligations, respectively. The deferral of revenue and expenses does not affect the amount, timing and any uncertainty of cash flows generated from operations.

The following table presents the impact of ASC 606 on Condensed Consolidated Statements of Operations (Unaudited):

| (Dollars in thousands)     | Three Months Ended September 30,<br>2018 |   |  |
|----------------------------|--|---|--|
|                            | As<br>Reported                           | Service<br>Revenues<br>and Costs<br>Adjustments | Pro-Forma<br>as if<br>Previous<br>Accounting<br>Guidance<br>Was in<br>Effect |
| Product revenue            | \$78,377                                 | \$ 10,207                                       | \$ 88,584  |
| Service revenue            | 10,153                                   | (10,153 )                                       | —  |
| Total revenue              | \$88,530                                 | \$ 54   | \$ 88,584  |
| Product cost of goods sold | \$36,979                                 | \$ —  | \$ 36,979  |

|                                     |          |           |   |           |
|-------------------------------------|----------|-----------|---|-----------|
| Service costs                       | 3,443    | (3,443    | ) | —         |
| Total cost of goods sold            | \$40,422 | \$ (3,443 | ) | \$ 36,979 |
| Gross profit                        | 48,108   | 3,497     |   | 51,605    |
| Gross profit percentage             | 54.3     | %         |   | 58.3 %    |
| Selling expenses                    | 22,175   | 3,468     |   | 25,643    |
| General and administrative expenses | 28,199   | —         |   | 28,199    |
| Operating expenses                  | 50,374   | 3,468     |   | 53,842    |

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Operating loss as reported was \$2.27 million whereas pro forma operating loss as if previous accounting guidance was in effect would have been \$2.24 million.

| (Dollars in thousands)              | Nine Months Ended September 30,<br>2018 |   |  |
|-------------------------------------|---|---|--|
|                                     | As<br>Reported                          | Service<br>Revenues<br>and Costs<br>Adjustments | Pro-Forma<br>as if<br>Previous<br>Accounting<br>Guidance<br>Was in<br>Effect |
| Product revenue                     | \$233,744                               | \$ 29,609                                       | \$263,353  |
| Service revenue                     | 29,627                                  | (29,627 )                                       | —  |
| Total revenue                       | \$263,371                               | \$ (18 )  | \$263,353  |
| Product cost of goods sold          | \$109,667                               | \$ —  | \$109,667  |
| Service costs                       | 10,247                                  | (10,247 )                                       | —  |
| Total cost of goods sold            | \$119,914                               | \$ (10,247 )                                    | \$109,667  |
| Gross profit                        | 143,457                                 | 10,229  | 153,686  |
| Gross profit percentage             | 54.5 %                                  |   | 58.4 %   |
| Selling expenses                    | 66,119                                  | 10,092  | 76,211   |
| General and administrative expenses | 72,213                                  | —   | 72,213   |
| Operating expenses                  | 138,332                                 | 10,092  | 148,424  |

Operating income as reported was \$5.13 million whereas pro forma operating income as if previous accounting guidance was in effect would have been \$5.26 million.

Disaggregated revenue by geographic area follows:

| (Dollars in thousands) | Three Months<br>Ended September<br>30, |          | Nine Months Ended<br>September 30, |           |
|------------------------|--|----------|------------------------------------|-----------|
|                        | 2018                                   | 2017     | 2018                               | 2017      |
| United States          | \$70,652                               | \$67,575 | \$210,596                          | \$202,176 |
| Canada                 | 17,878                                 | 8,076    | 52,775                             | 23,098    |
| Consolidated total     | \$88,530                               | \$75,651 | \$263,371                          | \$225,274 |

Disaggregated revenue by product type follows:

|                   | Three Months<br>Ended<br>September 30,<br>2018 |   | Nine Months<br>Ended<br>September 30,<br>2018 |   | Three Months<br>Ended<br>September 30,<br>2017 |   | Nine Months<br>Ended<br>September 30,<br>2017 |   |
|-------------------|--|---|---|---|--|---|---|---|
|                   |  | % |   | % |  | % |   | % |
| Fastening Systems | 24.6   | % | 20.4  | % | 24.5   | % | 20.6  | % |
| Fluid Power       | 14.6   | % | 16.3  | % | 14.7   | % | 15.7  | % |

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|                                 |        |        |        |        |
|---------------------------------|--------|--------|--------|--------|
| Specialty Chemicals             | 12.6 % | 14.5 % | 12.3 % | 14.3 % |
| Cutting Tools and Abrasives     | 13.7 % | 14.2 % | 13.5 % | 14.3 % |
| Electrical                      | 10.6 % | 11.7 % | 10.9 % | 11.9 % |
| Aftermarket Automotive Supplies | 7.6 %  | 8.4 %  | 8.0 %  | 8.8 %  |
| Safety                          | 4.6 %  | 4.2 %  | 4.6 %  | 4.2 %  |
| Welding and Metal Repair        | 1.7 %  | 2.2 %  | 1.9 %  | 2.2 %  |
| Other                           | 10.0 % | 8.1 %  | 9.6 %  | 8.0 %  |
| Consolidated Total              | 100.0% | 100.0% | 100.0% | 100.0% |

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## Note 3 — Restricted Cash

The Company has agreed to maintain \$0.8 million in a money market account as collateral for an outside party that is providing certain commercial card processing services for the Company. The Company is restricted from withdrawing this balance without the prior consent of the outside party during the term of the agreement. The adoption of ASU 2016-18 does not materially affect the accounting for restricted cash of the Company.

## Note 4 — Inventories, net

Inventories, net, consisting primarily of purchased goods which are offered for resale, were as follows:

|   | (Dollars in thousands) |                   |
|---|------------------------|-------------------|
|   | September 30, 2018     | December 31, 2017 |
| Inventories, gross                        | \$56,602               | \$56,492          |
| Reserve for obsolete and excess inventory | (5,448 )               | (5,564 )          |
| Inventories, net                          | \$51,154               | \$50,928          |

## Note 5 — Acquisition

In October 2017, the Company acquired Bolt Supply, based in Calgary, Canada, for a purchase price of approximately \$32.3 million. The purchase price was funded with cash on hand and utilization of Lawson Products' existing credit facility. Bolt Supply is a leading Canadian distributor of high quality fasteners, power tools and industrial MRO supplies, with 13 branch locations throughout Alberta, Saskatchewan, and Manitoba, Canada at the end of the third quarter 2018.

The purchase price of the acquisition was allocated to the fair market value of Bolt Supply's assets and liabilities on the acquisition date. The fair market value appraisals of the majority of the assets and liabilities were determined by third party valuation firms including intangible assets of \$7.2 million for trade names and \$4.2 million for customer relationships, respectively. The trade names and customer relationships intangible assets have estimated useful lives of 15 and 12 years, respectively. The \$14.0 million allocated to goodwill reflects the purchase price less the fair market value of the identifiable net assets. The fair values of the assets acquired and liabilities assumed, and the related tax balances, are based on estimates and assumptions. Further operating details related to the operations of Bolt Supply subsequent to the acquisition are included in Note 14 - Segment information.

The following table contains unaudited pro forma revenue and net income (loss) for Lawson Products assuming the Bolt Supply acquisition closed on January 1, 2016.

|           | (Dollars in thousands)           |          |                                 |           |
|-----------|----------------------------------|----------|---------------------------------|-----------|
|           | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|           | 2018                             | 2017     | 2018                            | 2017      |
| Revenue   |                                  |          |                                 |           |
| Actual    | \$88,530                         | \$75,651 | \$263,371                       | \$225,274 |
| Pro forma | 88,530                           | 85,156   | 263,371                         | 250,781   |

Net income (loss)

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|           |          |         |         |         |
|-----------|----------|---------|---------|---------|
| Actual    | \$(816 ) | \$1,321 | \$3,614 | \$9,451 |
| Pro forma | (816 )   | 1,534   | 3,614   | 10,175  |

The pro forma disclosures in the table above include adjustments for, amortization of intangible assets and acquisition costs to reflect results as if the acquisition of Bolt Supply had closed on January 1, 2016 rather than on the actual acquisition date. This pro forma information utilizes certain estimates, is presented for illustrative purposes only and is not intended to be indicative of the actual results of operation. In addition, future results may vary significantly from the results reflected in the pro forma information. The unaudited pro forma financial information does not reflect the impact of future positive or negative events that may occur after the acquisition, such as anticipated cost savings from operating synergies.

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## Note 6 - Goodwill

Goodwill activity for the first nine months of 2018 and 2017 is included in the table below:

|   | (Dollars in thousands)          |         |
|---|---------------------------------|---------|
|   | Nine Months Ended September 30, |         |
|   | 2018                            | 2017    |
| Beginning balance                             | \$19,614                        | \$5,520 |
| Adjustment to original acquisition allocation | (17 )                           | (73 )   |
| Impact of foreign exchange                    | (483 )                          | 342     |
| Ending balance                                | \$19,114                        | \$5,789 |

## Note 7 - Intangible assets

The gross carrying amount and accumulated amortization by intangible asset class were as follows:

|                        | (Dollars in thousands) |                          |                    | (Dollars in thousands) |                          |                    |
|------------------------|------------------------|--------------------------|--------------------|------------------------|--------------------------|--------------------|
|                        | September 30, 2018     |                          |                    | December 31, 2017      |                          |                    |
|                        | Gross Carrying Amount  | Accumulated Amortization | Net Carrying Value | Gross Carrying Amount  | Accumulated Amortization | Net Carrying Value |
| Trade names            | \$7,994                | \$ (1,341 )              | \$ 6,653           | \$8,182                | \$ (957 )                | \$ 7,225           |
| Customer relationships | 4,785                  | (537 )                   | 4,248              | 4,911                  | (323 )                   | 4,588              |
|                        | \$12,779               | \$ (1,878 )              | \$ 10,901          | \$13,093               | \$ (1,280 )              | \$ 11,813          |

Amortization expense of \$0.7 million and \$0.2 million related to intangible assets was recorded in General and administrative expenses for the nine months ended September 30, 2018 and 2017, respectively.

## Note 8 — Loan Agreement

## Lawson Loan Agreement

In 2012, the Company entered into a Loan and Security Agreement (“Loan Agreement”). The Loan Agreement consists of a \$40.0 million revolving line of credit facility, which includes a \$10.0 million sub-facility for letters of credit. Certain terms of the original Loan Agreement have been revised by subsequent amendments.

The Loan Agreement, as amended, expires in August 2020. Due to the lock box arrangement and a subjective acceleration clause contained in the Loan Agreement, any outstanding borrowings under the revolving line of credit are classified as a current liability.

Currently, credit available under the Loan Agreement, as amended, is based upon:

- a) 85% of the face amount of the Company’s eligible accounts receivable, generally less than 60 days past due, and
- b) the lesser of 60% of the lower of cost or market value of the Company’s eligible inventory, generally inventory expected to be sold within 18 months, or \$20.0 million.

The applicable interest rates for borrowings are at the Prime rate or, if the Company elects, the LIBOR rate plus 1.50% to 1.85% based on the Company's debt to EBITDA ratio. The Loan Agreement is secured by a first priority perfected security interest in substantially all existing assets of the Company. Dividends are restricted to amounts not to exceed \$7.0 million annually.

At September 30, 2018, the Company had \$8.4 million of borrowings under its revolving line of credit facility and additional borrowing availability of \$27.0 million. The Company paid interest of \$0.8 million and \$0.4 million for the nine months ended September 30, 2018 and 2017, respectively. The weighted average interest rate was 3.82% for the nine months ended September 30, 2018 and 3.91% for the nine months ended September 30, 2017.

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In addition to other customary representations, warranties and covenants, the Company is required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement, if the excess borrowing capacity is below \$10.0 million. On September 30, 2018, the Company's borrowing capacity exceeded \$10.0 million. Therefore, the Company was not subject to this financial covenant, however, for informational purposes the result of the financial covenant is provided below:

| Quarterly Financial Covenant  | Requirement | Actual      |
|-------------------------------|-------------|-------------|
| EBITDA to fixed charges ratio | 1.10 : 1.00 | 3.60 : 1.00 |

## Commitment Letter

Bolt Supply has a Commitment Letter with BMO Bank of Montreal ("BMO") dated March 30, 2017 which allows Bolt Supply to access up to \$5.5 million Canadian dollars in the form of either an overdraft facility or as commercial letters of credit. The Commitment Letter is cancellable at any time at BMO's sole discretion and is secured by substantially all of Bolt Supply's assets. It carries an interest rate of the bank's prime rate plus 0.25%. At September 30, 2018, Bolt Supply had \$2.0 million Canadian dollars of outstanding borrowings and remaining borrowing availability of \$3.5 million Canadian dollars. The Commitment Letter is subject to a working capital ratio of 1.35:1, a maximum ratio of debt to tangible net worth of 2.5:1 of the Bolt Supply assets and Debt Service Coverage Ratio 1.25:1 as defined in the Commitment Letter. At September 30, 2018, Bolt Supply was in compliance with all covenants which are subject to periodic review, at least annually, with the next review due by August 31, 2019.

## Note 9 — Severance Reserve

Changes in the Company's reserve for severance as of September 30, 2018 and 2017 were as follows:

|                                | (Dollars in thousands) |         |
|--------------------------------|------------------------|---------|
|                                | Nine Months Ended      |         |
|                                | September 30,          |         |
|                                | 2018                   | 2017    |
| Balance at beginning of period | \$483                  | \$1,710 |
| Charged to earnings            | 723                    | 595     |
| Payments                       | (787)                  | (1,625) |
| Balance at end of period       | \$419                  | \$680   |

## Note 10 — Stock-Based Compensation

The Company recorded stock-based compensation expense of \$8.7 million and \$2.7 million for the first nine months of 2018 and 2017, respectively. A portion of stock-based compensation is related to the change in the market value of the Company's common stock.

A summary of stock-based awards activity during the nine months ended September 30, 2018 follows:

## Stock Performance Rights ("SPRs")

The Company issued 44,737 SPRs to key employees with an exercise price of \$24.70 per share that cliff vest on December 31, 2020 and have a termination date of December 31, 2025.

## Restricted Stock Awards ("RSAs")

The Company issued 26,080 RSAs to members of the Company's Board of Directors with a vesting date of May 15, 2019 and issued 20,059 RSAs to key employees that cliff vest on December 31, 2020. Each RSA is exchangeable for

one share of the Company's common stock at the end of the vesting period.

Market Stock Units ("MSUs")

The Company issued 32,194 MSUs to key employees that cliff vest on December 31, 2020. MSU's are exchangeable for the Company's common stock at the end of the vesting period. The number of shares of common stock that will be issued upon vesting, ranging from zero to 48,291, will be determined based upon the trailing sixty-day weighted average closing price of the Company's common stock on December 31, 2020.

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For the three months ended September 30, 2018, the effect of restricted stock awards, market stock units and future stock option exercises equivalent of approximately 403,000 shares was excluded from the computation of diluted earnings per share because they would have been anti-dilutive. For the nine months ended September 30, 2018, stock options to purchase approximately 46,000 shares of the Company's common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive.

For the three and nine months ended September 30, 2017, stock options to purchase approximately 80,000 and 67,000 shares, respectively, of the Company's common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive.

### Note 11 — Income Taxes

The Company recorded income tax expenses of \$0.4 million, a 10.8% effective tax rate for the nine months ended September 30, 2018. The effective tax rate is lower than the U.S. statutory rate due mainly to discrete items such as the finalization of our calculation for previously untaxed foreign earnings and profits. The Securities and Exchange Commission ("SEC") recently issued SAB 118 (Income Tax Accounting Implications of the Tax Cuts and Jobs Act) which allows registrants to record provisional amounts during a measurement period. The SAB allows a company to recognize provisional amounts when it does not have the necessary information prepared in reasonable detail to calculate the effect of the change in tax law. Per the SAB, a company should report provisional amounts when the accounting is not complete, but for which a reasonable estimate can be determined. Lawson included in its 2017 taxable income calculation a provisional amount of approximately \$8.4 million representing previously untaxed foreign earnings and profits as of December 31, 2017. The Company did not accrue any federal income tax on this amount as the Company is able to utilize federal net operating losses to offset the income. The Company recently finalized the foreign earnings and profits calculation in conjunction with the finalization of 2017 federal income tax return when all required necessary information was more readily available. A lower final foreign earnings and profits inclusion resulted in a tax benefit which had a beneficial impact on the effective tax rate for the nine months ended September 30, 2018. Excluding the discrete items, the Company's effective tax rate was 33.5% for the nine months ended September 30, 2018. An income tax expense of \$0.8 million was recorded for the nine months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

The Company and its subsidiaries are subject to U.S. Federal income tax, as well as income tax of multiple state and foreign jurisdictions. As of September 30, 2018, the Company is subject to U.S. Federal income tax examinations for the years 2015 through 2017 and income tax examinations from various other jurisdictions for the years 2011 through 2017.

Earnings from the Company's foreign subsidiaries are considered to be indefinitely reinvested. A distribution of these non-U.S. earnings in the form of dividends or otherwise may subject the Company to foreign withholding taxes and U.S. federal and state taxes.

### Note 12 — Contingent Liabilities

In 2012, the Company identified that a site it owns in Decatur, Alabama, contains hazardous substances in the soil and groundwater as a result of historical operations prior to the Company's ownership. The Company retained an environmental consulting firm to further investigate the contamination including the measurement and monitoring of the site and the site was enrolled in the Alabama Department of Environmental Management ("ADEM") voluntary cleanup program.

As of December 31, 2017, the Company had received estimates from its environmental consulting firm for two remediation solutions based on a chemical injection process. The first solution consisted of chemical injections

throughout the entire site to directly eliminate the hazardous substances in the soil and groundwater. The second solution consisted of chemical injections around the perimeter of the site to prevent the migration of the hazardous chemicals off-site. Neither solution required additional excavation or repairs to be made to the property. The estimated expenditures over an 18 month period under the two injection scenarios ranged from \$0.9 million to \$2.0 million. The Company had determined that it would initially proceed with the method of injecting chemicals around the perimeter of the site to prevent the migration of the hazardous chemicals off-site. As of December 31, 2017, approximately \$1.0 million remained accrued for this remediation.

In June 2018, the Company received updated environmental remediation estimates from its environmental consulting firm based on information analyzed from further data collection and consultation with ADEM on their anticipated requirements. The updated remediation plan expands the chemical injection process over a larger area than previously estimated, including under the building on the property. The updated plan also requires four consecutive quarters of monitoring the affected area after the injection process is completed. Based upon feedback received from ADEM, the Company accrued an additional \$0.5 million of expense in the second quarter of 2018 to bring the total liability to \$1.4 million which represents the most likely outcome. This



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plan is expected to be approved by ADEM with remediation efforts commencing in the first quarter of 2019. The Company believes the environmental remediation liability of \$1.4 million currently accrued will be sufficient to cover the cost of the plan. The Company does not expect to capitalize any amounts related to the remediation plan.

Note 13 — Lease Termination

In the first quarter of 2012, the Company signed a 10 year agreement to lease space for a new corporate headquarters in Chicago, Illinois ("Lease"). In the fourth quarter of 2013, due to excess capacity as a result of a corporate restructuring, the Company agreed to sublease a portion (approximately 17,100 square feet) of its corporate headquarters to a third party ("Sublease"). Both the Lease and the Sublease were scheduled to terminate in the first quarter of 2023.

In the second quarter of 2018, the Company entered into agreements with the lessor and the sub lessee to terminate both the Lease and Sublease in June 2019. The original loss recorded on the Sublease was reduced by \$0.7 million in the second quarter of 2018 to reflect the shortened lease time frame. Additionally, the Company is required to pay a \$0.5 million fee before June 2019 as a condition of early termination of the original Lease. As a result of these transactions, a \$0.2 million net gain was recognized in the second quarter of 2018. The \$0.5 million early termination fee is included in current liabilities in the condensed consolidated balance sheet.

The termination of the Lease will reduce the Company's future operating lease obligation by \$1.2 million, offset by a reduction in future payments from the Sublease of \$0.4 million.

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## Note 14 – Segment Information

With the acquisition of Bolt Supply in the fourth quarter of 2017, the Company operates in two reportable segments. The businesses were determined to be separate reportable segments because of differences in their financial characteristics and the methods they employ to deliver product to customers. The operating segments are reviewed by the Company's chief operating decision maker responsible for reviewing operating performance and allocating resources. The Lawson segment primarily relies on its large network of sales representatives to visit the customer at the customers' work location and provide VMI service and produce sales orders for product that is then shipped to the customer. The Bolt Supply segment primarily sells product to customers through its branch locations. Bolt Supply had 13 branches in operation at the end of the third quarter 2018.

Financial information for the Company's reportable segments follows:

|                                   | (Dollars in thousands)           |          |                                 |           |
|-----------------------------------|----------------------------------|----------|---------------------------------|-----------|
|                                   | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|                                   | 2018                             | 2017     | 2018                            | 2017      |
| Revenue                           |                                  |          |                                 |           |
| Lawson product revenue            | \$68,539                         | \$75,651 | \$206,108                       | \$225,274 |
| Lawson service revenue            | 10,153                           | —        | 29,627                          | —         |
| Total Lawson revenue              | 78,692                           | 75,651   | 235,735                         | 225,274   |
| Bolt Supply                       | 9,838                            | —        | 27,636                          | —         |
| Consolidated total                | \$88,530                         | \$75,651 | \$263,371                       | \$225,274 |
| Gross profit                      |                                  |          |                                 |           |
| Lawson product gross profit       | \$37,742                         | \$46,005 | \$113,291                       | \$136,025 |
| Lawson service gross profit       | 6,710                            | —        | 19,380                          | —         |
| Total Lawson gross profit         | 44,452                           | 46,005   | 132,671                         | 136,025   |
| Bolt Supply                       | 3,656                            | —        | 10,786                          | —         |
| Consolidated total                | \$48,108                         | \$46,005 | \$143,457                       | \$136,025 |
| Operating income (loss)           |                                  |          |                                 |           |
| Lawson                            | \$(2,955)                        | \$1,090  | \$3,062                         | \$9,693   |
| Bolt Supply                       | 689                              | —        | 2,063                           | —         |
| Consolidated total                | (2,266)                          | 1,090    | 5,125                           | 9,693     |
| Interest expense                  | (251)                            | (133)    | (755)                           | (393)     |
| Other income (expense), net       | 170                              | 843      | (320)                           | 953       |
| Income (loss) before income taxes | \$(2,347)                        | \$1,800  | \$4,050                         | \$10,253  |

## Note 15 - Subsequent Events

On October 1, 2018, the Company completed the purchase of Screw Products, Inc., an industrial parts distributor for approximately \$5.2 million which was paid in cash at the time of closing. Screw Products has a location in Dallas, Texas and a location in Dayton, Ohio.

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

## Overview

The Maintenance, Repair and Operations ("MRO") distribution industry is highly fragmented. We compete for business with several national distributors as well as a large number of regional and local distributors. The MRO business is significantly impacted by the overall strength of the manufacturing sector of the U.S. economy. One measure used to evaluate the strength of the industrial products market is the PMI index published by the Institute for Supply Management, which is considered by many economists to be a reliable near-term economic barometer of the manufacturing sector. A measure above 50 generally indicates expansion of the manufacturing sector while a measure below 50 generally represents contraction. The average monthly PMI was 60.4 in the third quarter of 2018 compared to 58.7 in the third quarter of 2017, indicating a strong U.S. manufacturing economy.

Our sales are also affected by the number of sales representatives and their productivity. Our sales force consisted of an average of 967 and 991 sales representatives during the third quarters of 2018 and 2017, respectively. Our Lawson segment sales rep productivity, measured as sales per rep per day, increased 6.6% to \$1,292 in the third quarter of 2018 from \$1,212 in the third quarter of 2017. We anticipate moderate growth in the size of our sales force for the remainder of 2018 as we concentrate our efforts on providing training and support to continue to increase the productivity of our existing sales representatives.

In the fourth quarter of 2017 the Company acquired The Bolt Supply House, Ltd. ("Bolt Supply") which affects the comparison of operating results between the third quarter of 2018 compared to 2017. Additionally, the Company adopted ASC 606 on a modified retrospective basis as of January 1, 2018. Accordingly, 2017 amounts are not restated.

Quarter ended September 30, 2018 compared to quarter ended September 30, 2017

| (Dollars in thousands)              | 2018     |                | 2017     |                | % of Net Sales |
|-------------------------------------|----------|----------------|----------|----------------|----------------|
|                                     | Amount   | % of Net Sales | Amount   | % of Net Sales |                |
| Revenue                             | \$88,530 | 100.0 %        | \$75,651 | 100.0 %        |                |
| Cost of goods sold                  | 40,422   | 45.7 %         | 29,646   | 39.2 %         |                |
| Gross profit                        | 48,108   | 54.3 %         | 46,005   | 60.8 %         |                |
| Operating expenses:                 |          |                |          |                |                |
| Selling expenses                    | 22,175   | 25.0 %         | 24,354   | 32.2 %         |                |
| General and administrative expenses | 28,199   | 31.9 %         | 20,561   | 27.2 %         |                |
| Total SG&A                          | 50,374   | 56.9 %         | 44,915   | 59.4 %         |                |
| Operating income (loss)             | (2,266 ) | (2.6 )%        | 1,090    | 1.4 %          |                |
| Interest expense                    | (251 )   | (0.3 )%        | (133 )   | (0.2 )%        |                |
| Other income, net                   | 170      | 0.2 %          | 843      | 1.2 %          |                |
| Income (loss) before income taxes   | (2,347 ) | (2.7 )%        | 1,800    | 2.4 %          |                |

|                              |          |         |         |     |   |
|------------------------------|----------|---------|---------|-----|---|
| Income tax expense (benefit) | (1,531 ) | (1.8 )% | 479     | 0.7 | % |
| Net income (loss)            | \$(816 ) | (0.9 )% | \$1,321 | 1.7 | % |

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## Revenue and Gross Profits

| (Dollars in thousands)     | Three Months Ended |          | Increase          |        |
|----------------------------|--------------------|----------|-------------------|--------|
|                            | September 30, 2018 | 2017     | (Decrease) Amount | %      |
| <b>Revenue</b>             |                    |          |                   |        |
| Lawson                     | \$78,692           | \$75,651 | \$3,041           | 4.0%   |
| Bolt Supply                | 9,838              | —        | 9,838             |        |
| Consolidated               | \$88,530           | \$75,651 | \$12,879          | 17.0%  |
| <b>Gross profit</b>        |                    |          |                   |        |
| Lawson                     | \$44,452           | \$46,005 | \$(1,553)         | (3.4)% |
| Bolt Supply                | 3,656              | —        | 3,656             |        |
| Consolidated               | \$48,108           | \$46,005 | \$2,103           | 4.6%   |
| <b>Gross profit margin</b> |                    |          |                   |        |
| Lawson                     | 56.5               | % 60.8   | %                 |        |
| Bolt Supply                | 37.2               | %        |                   |        |
| Consolidated               | 54.3               | % 60.8   | %                 |        |

Total sales increased 17.0% to \$88.5 million in the third quarter of 2018 compared to \$75.7 million in the third quarter of 2017. There were 63 selling days in both periods. Average daily sales grew to \$1.405 million in the third quarter of 2018 compared to \$1.201 million in the prior year quarter. The Lawson segment total sales were positively impacted by a 6.6% improvement in sales productivity of sales representatives and a strong MRO marketplace. The third quarter of 2018 revenue was also positively impacted by \$9.8 million from the acquisition of Bolt Supply in the fourth quarter of 2017.

## Gross Profit

Gross profit increased \$2.1 million to \$48.1 million in the third quarter of 2018 compared to \$46.0 million in the third quarter of 2017, primarily due to increased sales and the acquisition of The Bolt Supply House, partially offset by \$3.4 million due to the adoption of ASC 606. Consolidated gross profit as a percent of sales decreased to 54.3% from 60.8% a year ago primarily due to the selling expense reclassification related to the separately identified vendor managed inventory services performance obligation costs that had historically been classified as selling expenses and the inclusion of Bolt Supply. Prior to the reclassification, the Lawson segment gross profit increased to 60.9%, essentially flat with gross profit percent of 60.8% a year ago.

## Selling, General and Administrative Expenses

| (Dollars in thousands)  | Three Months Ended September 30, |          | Increase (Decrease) |         |
|-------------------------|----------------------------------|----------|---------------------|---------|
|                         | 2018                             | 2017     | Amount              | %       |
| <b>Selling expenses</b> |                                  |          |                     |         |
| Lawson                  | \$21,372                         | \$24,354 | \$(2,982)           | (12.2)% |
| Bolt Supply             | 803                              | —        | 803                 |         |
| Consolidated            | \$22,175                         | \$24,354 | \$(2,179)           | (8.9)%  |

General and administrative expenses

|              |          |          |         |       |
|--------------|----------|----------|---------|-------|
| Lawson       | \$26,035 | \$20,561 | \$5,474 | 26.6% |
| Bolt Supply  | 2,164    | —        | 2,164   |       |
| Consolidated | \$28,199 | \$20,561 | \$7,638 | 37.1% |

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Selling expenses consist of compensation and support for our sales representatives. Selling expenses decreased to \$22.2 million in the third quarter of 2018 from \$24.4 million in the prior year quarter and, as a percent of sales, decreased to 25.0% from 32.2% in the third quarter of 2017. The \$2.2 million decrease is primarily due to the \$3.5 million reclassification of services expense related to the separately identified vendor managed inventory services performance obligation to cost of revenues, partially offset by the inclusion of Bolt Supply in the quarter. As a percent of sales, selling expenses decreased to 25.0% from 32.2% due primarily to the reclassification of expenses to cost of sales and the proportionately lower selling expense structure in Bolt Supply's operations.

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses increased to \$28.2 million in the third quarter of 2018 from \$20.6 million in the prior year quarter. The increase was primarily driven by \$7.6 million of stock based compensation expense, a portion of which fluctuates with the Company stock price, and inclusion of Bolt Supply expenses.

## Interest Expense and Other Income, Net

Interest expense increased \$0.1 million over the prior year quarter, due primarily to increased borrowings related to the Bolt Supply acquisition. Other income, net decreased \$0.7 million over the prior year quarter due primarily to the lower volatility in the Canadian currency exchange rate in the third quarter 2018 compared to the third quarter 2017.

## Income Tax Expense

Income tax benefit of \$1.5 million, resulting in a 65.2% effective tax rate, was recorded for the three months ended September 30, 2018. Our effective tax rate is higher than the U.S. statutory rate due mainly to state taxes, income in higher tax jurisdictions, a Global Intangible Low Taxed Income Inclusion as a result of the 2017 Tax Cuts and Jobs Act, and other discrete items which primarily consisted of the finalization of foreign earnings and profit calculation. Excluding discrete items our effective tax rate was 25.7% for the three months ended September 30, 2018. In the fourth quarter of 2017, the Company eliminated substantially all of its U.S. reserves against its deferred tax assets as the Company was in a three year cumulative income position in the U.S. and we had reached a point of increased confidence in our ability to sustain profit levels. An income tax expense of \$0.5 million was recorded for the three months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

## Nine months ended September 30, 2018 compared to September 30, 2017

| (\$ in thousands)                   | 2018      |                | 2017      |                |
|-------------------------------------|-----------|----------------|-----------|----------------|
|                                     | Amount    | % of Net Sales | Amount    | % of Net Sales |
| Revenue                             | \$263,371 | 100.0 %        | \$225,274 | 100.0 %        |
| Cost of goods sold                  | 119,914   | 45.5 %         | 89,249    | 39.6 %         |
| Gross profit                        | 143,457   | 54.5 %         | 136,025   | 60.4 %         |
| Operating expenses:                 |           |                |           |                |
| Selling expenses                    | 66,119    | 25.1 %         | 72,964    | 32.4 %         |
| General and administrative expenses | 72,213    | 27.5 %         | 58,790    | 26.1 %         |
| Total SG&A                          | 138,332   | 52.6 %         | 131,754   | 58.5 %         |
| Gain on sale of property            | —         | — %            | (5,422)   | (2.4)%         |
| Operating expenses                  | 138,332   | 52.6 %         | 126,332   | 56.1 %         |

|                             |         |     |      |         |      |   |      |    |
|-----------------------------|---------|-----|------|---------|------|---|------|----|
| Operating income            | 5,125   | 1.9 | %    | 9,693   | 4.3  | % |      |    |
| Interest expense            | (755    | )   | (0.3 | )%      | (393 | ) | (0.2 | )% |
| Other income (expense), net | (320    | )   | (0.1 | )%      | 953  |   | 0.5  | %  |
| Income before income taxes  | 4,050   | 1.5 | %    | 10,253  | 4.6  | % |      |    |
| Income tax expense          | 436     | 0.1 | %    | 802     | 0.4  | % |      |    |
| Net income                  | \$3,614 | 1.4 | %    | \$9,451 | 4.2  | % |      |    |

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## Revenue and Gross Profit

| (Dollars in thousands) | Nine Months Ended<br>September 30, |           | Increase<br>(Decrease) |        |
|------------------------|------------------------------------|-----------|------------------------|--------|
|                        | 2018                               | 2017      | Amount                 | %      |
| Revenue                |                                    |           |                        |        |
| Lawson                 | \$235,735                          | \$225,274 | \$10,461               | 4.6%   |
| Bolt Supply            | 27,636                             | —         | 27,636                 |        |
| Consolidated           | \$263,371                          | \$225,274 | \$38,097               | 16.9%  |
| Gross profit           |                                    |           |                        |        |
| Lawson                 | \$132,671                          | \$136,025 | \$(3,354)              | (2.5)% |
| Bolt Supply            | 10,786                             | —         | 10,786                 |        |
| Consolidated           | \$143,457                          | \$136,025 | \$7,432                | 5.5%   |
| Gross profit margin    |                                    |           |                        |        |
| Lawson                 | 56.3                               | % 60.4    |                        | %      |
| Bolt Supply            | 39.0                               | %         |                        |        |
| Consolidated           | 54.5                               | % 60.4    |                        | %      |

## Revenue

Revenue for the nine months ended September 30, 2018 increased 16.9% to \$263.4 million from \$225.3 million for the nine months ended September 30, 2017. Average daily sales improved 17.6% to \$1.386 million in the first nine months of 2018 compared to \$1.179 million in the prior year period. The first nine months of 2018 and 2017 had 190 and 191 selling days, respectively. Sales in the first nine months of 2018 were positively impacted by improved year to date sales rep productivity of 7.4%, the effect of the Bolt acquisition and a strong MRO marketplace, as shown by the increase in average PMI to 59.6 from 57.1 in the prior year to date.

## Gross Profit

Gross profit increased to \$143.5 million in the first nine months of 2018 compared to \$136.0 million in the first nine months of 2017 and decreased as a percent of sales to 54.5% from 60.4% a year ago. The decline in the gross profit margin percentage from a year ago was primarily driven by a \$10.2 million selling expense reclassification related to the separately identified vendor managed inventory services performance obligation costs that had historically been classified as selling expenses, the inclusion of Bolt Supply and higher sales to large national customers who typically have lower product margins. Prior to the reclassification, the Lawson segment gross profit was 60.6%, essentially flat with 60.4% a year ago.

## Selling, General and Administrative Expenses

| (Dollars in thousands) | Nine Months<br>Ended September<br>30, |          | Increase<br>(Decrease) |         |
|------------------------|---------------------------------------|----------|------------------------|---------|
|                        | 2018                                  | 2017     | Amount                 | %       |
| Selling expenses       |                                       |          |                        |         |
| Lawson                 | \$63,870                              | \$72,964 | \$(9,094)              | (12.5)% |

|              |          |          |            |        |
|--------------|----------|----------|------------|--------|
| Bolt Supply  | 2,249    | —        | 2,249      |        |
| Consolidated | \$66,119 | \$72,964 | \$(6,845 ) | (9.4)% |

General and administrative expenses

|        |          |          |         |       |
|--------|----------|----------|---------|-------|
| Lawson | \$65,739 | \$58,790 | \$6,949 | 11.8% |
|--------|----------|----------|---------|-------|

|             |       |   |       |  |
|-------------|-------|---|-------|--|
| Bolt Supply | 6,474 | — | 6,474 |  |
|-------------|-------|---|-------|--|

|              |          |          |          |       |
|--------------|----------|----------|----------|-------|
| Consolidated | \$72,213 | \$58,790 | \$13,423 | 22.8% |
|--------------|----------|----------|----------|-------|

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Selling Expenses

Selling expenses decreased to \$66.1 million for the first nine months of 2018 from \$73.0 million in the first nine months of 2017. The decrease is primarily due to the \$10.2 million reclassification of services expense related to the separately identified vendor managed inventory services obligation to cost of revenues, partially offset by the inclusion of Bolt Supply and increased compensation costs on higher sales.

General and Administrative Expenses

General and administrative expenses increased to \$72.2 million in the first nine months of 2017 from \$58.8 million in the prior year period primarily driven by increased stock-based compensation expense of \$6.0 million, a portion of which varies with the company stock price, and the inclusion of Bolt Supply expenses of \$6.5 million.

Gain on sale of property

In the second quarter of 2017, we received net cash proceeds of \$6.2 million and recognized a gain of \$5.4 million from the sale of our Fairfield, New Jersey distribution center.

Interest Expense

Interest expenses increased \$0.4 million in the first nine months of 2018, over the prior year, due primarily to higher average borrowings outstanding.

Other (expense) Income, Net

Other (expense) income, net decreased \$1.3 million in the first nine months of 2018, primarily due to the effect of changes in the Canadian currency exchange rate.

Income Tax Expense

Income tax expenses were \$0.4 million resulting in a 10.8% effective tax rate for the nine months ended September 30, 2018. Our effective tax rate is lower than the U.S. statutory rate due to discrete items such as the finalization of our calculation for previously untaxed foreign earnings and profits. Excluding discrete items, the Company's effective tax rate was 33.5% for the nine months ended September 30, 2018. In the fourth quarter of 2017, the Company eliminated substantially all of its U.S. reserves against its deferred tax assets as the Company was in a three year cumulative income position in the U.S. and we had reached a point of increased confidence in our ability to sustain profit levels. Income tax expense of \$0.8 million was recorded for the nine months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

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### Liquidity and Capital Resources

Available cash and cash equivalents were \$7.7 million on September 30, 2018 compared to \$4.4 million on December 31, 2017. Net cash provided by operations for the nine months ended September 30, 2018 and 2017 was \$10.2 million and \$3.8 million, respectively, as cash generated by operating earnings was partially offset by cash invested in working capital, primarily to support the increase in sales.

Capital expenditures, primarily for improvements to our distribution centers and information technology, were \$1.6 million and \$1.2 million for the nine month periods ended September 30, 2018 and 2017, respectively. In the second quarter of 2017, we completed the sale of our distribution center located in Fairfield, New Jersey, receiving net cash proceeds of \$6.2 million.

The Company used \$4.6 million in financing activities primarily resulting from net payments on its revolving lines of credit.

Subsequent to the reporting period ended September 30, 2018, we completed the acquisition of Screw Products, Inc. with a cash payment of \$5.2 million.

We believe cash provided by operations and funds available under our Loan Agreements are sufficient to fund our operating requirements, strategic initiatives and capital improvements for the next 12 months.

### Lawson Loan Agreement

On September 30, 2018, we had \$8.4 million of borrowings under our Lawson revolving line of credit facility and we had additional borrowing availability of \$27.0 million. Dividends are currently restricted under the Lawson Loan Agreement to amounts not to exceed \$7.0 million annually and no dividends were paid to shareholders in the nine months ended September 30, 2018 and 2017.

In addition to other customary representations, warranties and covenants, if the excess borrowing capacity under our revolving line of credit facility is below \$10.0 million, we are required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement. On September 30, 2018, our borrowing capacity exceeded \$10.0 million, therefore, we were not subject to this financial covenant. However, for informational purposes we have provided the result of the financial covenant below:

| Quarterly Financial Covenant  | Requirement | Actual      |
|-------------------------------|-------------|-------------|
| EBITDA to fixed charges ratio | 1.10 : 1.00 | 3.60 : 1.00 |

While we were in compliance with the financial covenant for the quarter ended September 30, 2018, failure to meet this covenant requirement in future quarters could lead to higher financing costs, increased restrictions, or reduce or eliminate our ability to borrow funds and could have a material adverse effect on our business, financial condition and results of operations.

### Bolt Commitment Letter

At September 30, 2018, Bolt had \$2.0 million Canadian dollars of outstanding borrowings and remaining borrowing availability of \$3.5 million Canadian dollars under a Commitment Letter. The Commitment Letter is subject to a working capital ratio of 1.35:1, a maximum ratio of debt to tangible net worth of 2.5:1 of the Bolt assets and Debt Service Coverage Ratio 1.25:1 as defined in the Commitment Letter. At September 30, 2018, Bolt was in compliance with all covenants which are subject to periodic review, at least annually, with the next review due by August 31, 2019.



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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk at September 30, 2018 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as 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 (the "Evaluation Date"). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that the information relating to Lawson, including our consolidated subsidiaries, required to be disclosed in our SEC reports (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) includes, without limitation, controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II  
OTHER INFORMATION

ITEMS 1, 1A, 2, 3, 4 and 5 of Part II are inapplicable and have been omitted from this report.

ITEM 6. EXHIBITS

Exhibit #

- 31.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

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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.

LAWSON PRODUCTS, INC.  
(Registrant)

Dated: October 25, 2018 /s/ Michael G. DeCata  
Michael G. DeCata  
President and Chief Executive Officer  
(principal executive officer)

Dated: October 25, 2018 /s/ Ronald J. Knutson  
Ronald J. Knutson  
Executive Vice President, Chief Financial Officer, Treasurer and Controller  
(principal financial and accounting officer)