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, 2019

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 incorporation or organization)	**(I.R.S. Employer 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)

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

Title of each class	Trading Symbol	Name of each exchange on which registered
Common stock, $1.00 par value	LAWS	NASDAQ Global Select Market

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, 2019 was 8,961,648.

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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 lines 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 costs, tariffs and the cost of raw materials, including 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;
- Luther King Capital's significant influence over the Company given its ownership percentage; 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, 2018.

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.

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

Lawson Products, Inc.
Condensed Consolidated Balance Sheets
(Dollars in thousands, except share data)

	September 30, 2019	December 31, 2018
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	$ 8,626	$ 11,883
Restricted cash	800	800
Accounts receivable, less allowance for doubtful accounts of $614 and $549, respectively	45,162	37,682
Inventories, net	54,894	52,887
Miscellaneous receivables and prepaid expenses	4,270	3,653
Total current assets	113,752	106,905
Property, plant and equipment, net	16,932	23,548
Deferred income taxes	17,372	20,592
Goodwill	20,582	20,079
Cash value of life insurance	14,440	12,599
Intangible assets, net	12,468	13,112
Lease assets	11,917	—
Other assets	275	307
Total assets	$ 207,738	$ 197,142
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Revolving lines of credit	$ 2,195	$ 10,823
Accounts payable	16,325	15,207
Lease obligation	3,781	—
Accrued expenses and other liabilities	37,873	40,179
Total current liabilities	60,174	66,209
Security bonus plan	11,969	12,413
Lease obligation	10,360	5,213
Deferred compensation	5,915	5,304
Deferred tax liability	2,879	2,761
Other liabilities	3,460	6,069
Total liabilities	94,757	97,969
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 - 9,042,597 and 9,005,716 shares, respectively Outstanding - 8,956,981 and 8,955,930 shares, respectively	9,043	9,006
Capital in excess of par value	17,626	15,623
Retained earnings	89,502	77,338
Treasury stock – 85,616 and 49,786 shares, respectively	(2,595)	(1,234)
Accumulated other comprehensive loss	(595)	(1,560)
Total stockholders' equity	112,981	99,173
Total liabilities and stockholders' equity	$ 207,738	$ 197,142

See notes to condensed consolidated financial statements.

Lawson Products, Inc.
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)
(Dollars in thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Product revenue	$ 84,440	$ 78,377	$ 252,351	$ 233,744
Service revenue	10,339	10,153	29,868	29,627
Total revenue	94,779	88,530	282,219	263,371
Product cost of goods sold	39,635	36,979	118,222	109,667
Service costs	4,570	3,443	13,457	10,247
Gross profit	50,574	48,108	150,540	143,457
Operating expenses:				
Selling expenses	21,255	22,175	64,864	66,119
General and administrative expenses	22,873	28,199	72,063	72,213
Operating expenses	44,128	50,374	136,927	138,332
Operating income (loss)	6,446	(2,266)	13,613	5,125
Interest expense	(138)	(251)	(481)	(755)
Other income (expense), net	(13)	170	798	(320)
Income (loss) before income taxes	6,295	(2,347)	13,930	4,050
Income tax expense (benefit)	1,521	(1,531)	3,703	436
Net income (loss)	$ 4,774	$ (816)	$ 10,227	$ 3,614
Basic income per share of common stock	$ 0.53	$ (0.09)	$ 1.14	$ 0.41
Diluted income per share of common stock	$ 0.51	$ (0.09)	$ 1.09	$ 0.39
Weighted average shares outstanding:				
Basic weighted average shares outstanding	8,974	8,919	8,971	8,904
Effect of dilutive securities outstanding	415	—	399	346
Diluted weighted average shares outstanding	9,389	8,919	9,370	9,250
Comprehensive income (loss):				
Net income (loss)	$ 4,774	$ (816)	$ 10,227	$ 3,614
Other comprehensive income (loss), net of tax				
Adjustment for foreign currency translation	(427)	692	965	(769)
Net comprehensive income (loss)	$ 4,347	$ (124)	$ 11,192	$ 2,845

See notes to condensed consolidated financial statements.

Lawson Products, Inc.
Condensed Consolidated Statements of Changes in Stockholders' Equity - 2019
(Dollars in thousands)
(Unaudited)

	Common Stock						
	Outstanding Shares	$1 Par Value	Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at January 1, 2019	8,955,930	$ 9,006	$ 15,623	$ 77,338	$ (1,234)	$ (1,560)	$ 99,173
Change in accounting principle (1)	—	—	—	1,937	—	—	1,937
Net income	—	—	—	4,146	—	—	4,146
Adjustment for foreign currency translation	—	—	—	—	—	675	675
Stock-based compensation	—	—	666	—	—	—	666
Shares issued	6,520	6	(6)	—	—	—	—
Balance at March 31, 2019	8,962,450	9,012	16,283	83,421	(1,234)	(885)	106,597
Net income	—	—	—	1,307	—	—	1,307
Adjustment for foreign currency translation	—	—	—	—	—	717	717
Stock-based compensation	—	—	711	—	—	—	711
Shares issued	20,712	21	(21)	—	—	—	—
Balance at June 30, 2019	8,983,162	$ 9,033	$ 16,973	$ 84,728	$ (1,234)	$ (168)	$ 109,332
Net income	—	—	—	4,774	—	—	4,774
Treasury shares repurchased	(35,830)	—	—	—	(1,361)	—	(1,361)
Adjustment for foreign currency translation	—	—	—	—	—	(427)	(427)
Stock-based compensation	—	—	663	—	—	—	663
Shares issued	9,649	10	(10)	—	—	—	—
Balance at September 30, 2019	8,956,981	9,043	17,626	89,502	(2,595)	(595)	112,981

(1) The Company adopted the ASC No.842, Leases (ASC 842) on January 1, 2019 using the modified retrospective approach. See Note 2 - Leases for further details.

See notes to condensed consolidated financial statements.

Lawson Products, Inc.
Condensed Consolidated Statements of Changes in Stockholders' Equity - 2018
(Dollars in thousands)
(Unaudited)

	Common Stock						
	Outstanding Shares	$1 Par Value	Capital in Excess of Par Value	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance at January 1, 2018	8,888,028	$ 8,921	$ 13,005	$ 71,453	$ (711)	$ 822	$ 93,490
Change in accounting principle [2]	—	—	—	(329)	—	—	(329)
Net income	—	—	—	1,236	—	—	1,236
Adjustment for foreign currency translation	—	—	—	—	—	(1,483)	(1,483)
Stock-based compensation	—	—	651	—	—	—	651
Shares issued	307	1	(1)	—	—	—	—
Balance at March 31, 2018	8,888,335	8,922	13,655	72,360	(711)	(661)	93,565
Net income	—	—	—	3,194	—	—	3,194
Adjustment for foreign currency translation	—	—	—	—	—	22	22
Stock-based compensation	—	—	673	—	—	—	673
Shares issued	30,304	30	(30)	—	—	—	—
Balance at June 30, 2018	8,918,639	$ 8,952	$ 14,298	$ 75,554	$ (711)	$ (639)	$ 97,454
Net loss	—	—	—	(816)	—	—	(816)
Adjustment for foreign currency translation	—	—	—	—	—	692	692
Stock-based compensation	—	—	692	—	—	—	692
Shares issued	1,005	1	(1)	—	—	—	—
Balance at September 30, 2018	8,919,644	8,953	14,989	74,738	(711)	53	98,022

(2) The Company adopted the ASC 606, Revenue from Contracts with Customers (ASC 606) on January 1, 2018 using the modified retrospective approach.

See notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30,	
	2019	2018
Operating activities:		
Net income	$ 10,227	$ 3,614
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,401	5,120
Stock-based compensation	7,621	8,694
Deferred income taxes	3,252	830
Changes in operating assets and liabilities:		
Accounts receivable	(7,785)	(5,624)
Inventories	(1,593)	(566)
Prepaid expenses and other assets	(2,433)	(3,651)
Accounts payable and other liabilities	(6,193)	1,443
Other	544	442
Net cash provided by operating activities	$ 8,041	$ 10,302
Investing activities:		
Purchases of property, plant and equipment	$ (1,392)	$ (1,626)
Business acquisition	—	(157)
Net cash used in investing activities	$ (1,392)	$ (1,783)
Financing activities:		
Net payments on revolving lines of credit	$ (8,628)	$ (4,625)
Repurchase treasury shares	(1,361)	—
Payment of financing lease principal	(192)	(128)
Proceeds from stock option exercises	16	14
Net cash used in financing activities	$ (10,165)	$ (4,739)
Effect of exchange rate changes on cash and cash equivalents	$ 259	$ (533)
Increase (decrease) in cash, cash equivalents and restricted cash	(3,257)	3,247
Cash, cash equivalents and restricted cash at beginning of period	12,683	5,216
Cash, cash equivalents and restricted cash at end of period	$ 9,426	$ 8,463
Cash and cash equivalents	$ 8,626	$ 5,992
Restricted cash	800	800
Cash, cash equivalents and restricted cash	$ 9,426	$ 8,463
Supplemental disclosure of cash flow information		
Net cash paid for income taxes	$ 458	$ 1,135

See notes to condensed consolidated financial statements.

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, 2018. 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, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019.

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 14 branches in operation at the end of the third quarter 2019.

Note 2 - Leases

In February 2016 the FASB established Topic ASC 842, Leases, by issuing Accounting Standards Update 2016-02. Lawson adopted ASC 842 as of January 1, 2019. The Company leases property used for distribution centers, office space, and Bolt branch locations throughout the US and Canada, along with various equipment located in distribution centers and corporate headquarters. The Company is also a lessor of its Decatur, Alabama property previously used in conjunction with a discontinued operation, and is a sublessor of a portion of its corporate headquarters.

Lawson Operating Leases

Lawson MRO primarily has two types of leases: leases for real estate and leases for equipment. Operating real estate leases that have a material impact on the operations of the Company are related to the Company's distribution network and headquarters. The Company possesses several additional property leases that are month to month basis and are not material in nature. Lawson MRO does not possess any leases that have residual value guarantees. Several property leases include renewal clauses which vary in length and may not include specific rent renewal amounts. The Company will revise the value of the right of use assets and associated lease liabilities when the Company is reasonably certain it will renew a lease.

The key change commencing on January 1, 2019 for the Company is the recognition of assets and liabilities of operating leases with lease terms longer than twelve months that were not previously capitalized on the balance sheet. The value of the Right Of Use ("ROU") assets and associated lease liabilities is calculated using the total cash payments over the course of the lease, discounted to the present value using the appropriate incremental borrowing rate. The right of use asset will be amortized over its useful life. Similar to deferred rent under ASC 840, the lease liability is reduced in conjunction with the lease payments made, with adjustments made to the lease liability in order to account for non-straight line cash payments through the life of the lease.

Bolt primarily leases the real estate for its branch locations as well as its distribution center in Calgary, Alberta. Bolt possesses additional property leases that are month to month and not material in nature. Bolt property leases include renewal clauses which vary in length and may not include specific rent renewal amounts. The Company will revise the value of the right of use asset and associated lease liability when the Company is reasonably certain it will renew a lease.

Lease of McCook Distribution Facility

Upon adoption of ASC 842, the previously capitalized financing asset and lease liability for the McCook distribution facility was removed from the balance sheet and re-established as a ROU asset and a lease liability as an operating lease. The Company did not include the lease renewal periods in its assessment of the McCook lease as it did not meet the reasonably certain threshold required under ASC 842. Changes in the value of the assets and liabilities associated with the property due to adoption of ASC 842 have been accounted for as an adjustment to beginning retained earnings of $1.9 million.

Accounting Policy Elections

As part of the transition to ASC 842, the Company elected the following practical expedients:

The transitional package of practical expedients as prescribed by ASC 842. Per the practical expedient for the transition to ASC 842, the Company did not reassess expired leases, existing lease classifications or initial indirect costs for existing leases in the calculation of the right to use asset and lease liability.

The Company elected the modified retrospective method of transition, which resulted in no restatement of prior period results with the adoption impact being recorded to opening retained earnings.

The Company did not capitalize short term leases, for all asset classes defined as leases with a term of shorter than twelve months, on the balance sheet. These leases have not been transitioned to ASC 842.

As a practical expedient, the Company did not reassess the accounting for initial direct costs of current leases.

The Company elected not to use the hindsight practical expedient in determining the lease term.

The Company recognizes certain lease components and non-lease components together and not as separate parts of a lease for real estate leases. The Company will exercise this practical expedient in the future by asset class.

Significant Assumptions

The Company is required to determine a discount rate for the present value of lease payments. If the rate is not included in the lease or cannot be readily determined, the Company must estimate the incremental borrowing rate to be used for the discount rate. The Company determined that Lawson MRO and Bolt have different discount rates for leases, as both reporting units have separate borrowing agreements. The Lawson MRO segment will discount the present value of the total payments for the operating and financing leases using the incremental borrowing rate of 5.5%, given the similarity of the lease terms amongst asset classes. The Bolt segment will discount the present value of the total payments of each operating and financing lease at its incremental borrowing rate of 4.2%. The discount rate of Lawson MRO and Bolt will be reviewed on a periodic basis and updated as needed.

The expenses and income generated by the leasing activity of Lawson as lessee for the three and nine months ending September 30, 2019 are as follows (Dollars in thousands):

Lease Type	Classification	Three Months Ending September 30, 2019	Nine Months Ending September 30, 2019
Consolidated Operating Lease Expense [1]	Operating expenses	$ 1,190	$ 3,532
Consolidated Financing Lease Amortization	Operating expenses	60	159
Consolidated Financing Lease Interest	Interest expense	10	23
Consolidated Financing Lease Expense		70	182
Sublease Income [2]	Operating expenses	—	(160)
Net Lease Cost		$ 1,260	$ 3,554

(1) Includes short term lease expense, which is immaterial
(2) Sublease income from sublease of a portion of the Company headquarters. The sublease was terminated in June 2019 and the Company has no other subleases.

The Company recorded $1.1 million and $3.3 million of operating lease expenses for the three and nine months ended September 30, 2018, respectively.

The value of the net assets and liabilities generated by the leasing activity of Lawson as lessee as of September 30, 2019 are as follows (Dollars in thousands):

Lease Type	Amount
Total ROU operating lease assets [1]	$ 11,258
Total ROU financing lease assets [2]	659
Total lease assets	$ 11,917
Total current operating lease obligation	$ 3,534
Total current financing lease obligation	247
Total current lease obligations	$ 3,781
Total long term operating lease obligation	$ 9,976
Total long term financing lease obligation	384
Total long term lease obligation	$ 10,360

[1] Operating lease assets are recorded net of accumulated amortization of $2.1 million as of September 30, 2019
[2] Financing lease assets are recorded net of accumulated amortization of $0.2 million as of September 30, 2019

The value of the lease liabilities generated by the leasing activities of Lawson as lessee as of September 30, 2019 were as follows (Dollars in thousands):

Maturity Date of Lease Liabilities	Operating Leases	Financing Leases	Total
Year one	$ 4,097	$ 258	$ 4,355
Year two	4,141	214	4,355
Year three	3,582	118	3,700
Year four	1,717	70	1,787
Year five	701	20	721
Subsequent years	627	—	627
Total lease payments	14,865	680	15,545
Less: Interest	1,355	49	1,404
Present value of lease liabilities	$ 13,510	$ 631	$ 14,141

The Company's future minimum lease commitments as of December 31, 2018, were as follows (Dollars in thousands):

Maturity Date of Lease Liabilities	Operating Leases [2][3]	Financing Lease [3][4]	Capital Leases [4]
Year one	$ 2,574	$ 1,395	$ 201
Year two	2,369	1,444	155
Year three	2,349	1,493	91
Year four	2,008	760	11
Year five	1,130	—	—
Subsequent years	374	—	—
Total lease payments [1]	$ 10,804	$ 5,092	$ 458

(1) Minimum lease payments exclude payments to landlord for real estate taxes and common area maintenance
(2) On January 1, 2019, the Company elected the modified retrospective method of transition to adopt the new lease standard ASC 842, which resulted in no restatement of prior period results. At December 31, 2018, prior to adoption of the new lease standard, operating lease obligations were not included as a liability on the balance sheet. Therefore, the operating lease obligations are included in the table for comparative purposes only and the total lease liability is not included as it is not applicable
(3) The $5.1 million minimum lease obligation attributable to the McCook lease that was classified as a financing lease on December 31, 2018 was reclassified as an operating lease under the new accounting standard adopted on January 1, 2019
(4) Lease obligations classified as capital leases on December 31, 2018 were reclassified as financing leases under the new lease standard adopted on January 1, 2019

The weighted average lease terms and interest rates of the leases held by Lawson as of September 30, 2019 are as follows:

Lease Type	Weighted Average Term in Years	Weighted Average Interest Rate
Operating Leases	4.0	5.1%
Financing Leases	3.0	5.5%

The cash outflows of the leasing activity of Lawson as lessee for the nine months ending September 30, 2019 are as follows (Dollars in thousands):

Cash Flow Source	Classification	Amount
Operating cash flows from operating leases	Operating activities	$ 3,014
Operating cash flows from financing leases	Operating activities	14
Financing cash flows from financing leases	Financing activities	192

Lawson as Lessor

The Company is a lessor of its facility in Decatur, Alabama, which was previously used in conjunction with a discontinued operation. The lease expires in February, 2024. Both the lessor and lessee have a put option to each other upon the completion of the remediation of the environmental matter at a pre-negotiated price less 50% of the rent paid upon the put option being exercised. The net book value at September 30, 2019 is $0.4 million. The Company classifies this lease as an operating lease. The operating lease of the Decatur facility generated approximately $0.1 million of income to the Company for the nine months ending September 30, 2019. Annual lease income classified as operating expenses of $0.2 million is anticipated through the earlier of the put option exercise or February, 2024.

Note 3 - 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 reports two separate revenue streams and two separate costs of revenues.

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.

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, 2019, 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.

Disaggregated revenue by geographic area follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in thousands)	2019	2018	2019	2018
United States	$ 75,160	$ 70,652	$ 225,327	$ 210,596
Canada	19,619	17,878	56,892	52,775
Consolidated total	$ 94,779	$ 88,530	$ 282,219	$ 263,371

Disaggregated revenue by product type follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Fastening Systems	24.1%	24.6%	24.0%	24.5%
Fluid Power	15.1%	14.6%	15.2%	14.7%
Cutting Tools and Abrasives	13.1%	13.7%	13.1%	13.5%
Specialty Chemicals	11.7%	12.6%	11.6%	12.3%
Electrical	10.4%	10.6%	10.8%	10.9%
Aftermarket Automotive Supplies	7.6%	7.6%	7.9%	8.0%
Safety	4.7%	4.6%	4.7%	4.6%
Welding and Metal Repair	1.3%	1.7%	1.5%	1.9%
Other	12.0%	10.0%	11.2%	9.6%
Consolidated Total	100.0%	100.0%	100.0 %	100.0 %

Note 4 — 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.

Note 5 — Inventories, Net

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

	(Dollars in thousands)	
	September 30, 2019	December 31, 2018
Inventories, gross	$ 59,552	$ 58,215
Reserve for obsolete and excess inventory	(4,658)	(5,328)
Inventories, net	$ 54,894	$ 52,887

Note 6 - Goodwill

Goodwill activity for the first nine months of 2019 and 2018 is included in the table below:

	(Dollars in thousands) Nine Months Ended September 30,	
	2019	2018
Beginning balance	$ 20,079	$ 19,614
Adjustment to original acquisition allocation	(12)	(17)
Impact of foreign exchange	515	(483)
Ending balance	$ 20,582	$ 19,114

Note 7 - Intangible Assets

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

	(Dollars in thousands)					
	September 30, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade names	$ 8,289	$ (1,866)	$ 6,423	$ 8,090	$ (1,447)	$ 6,643
Customer relationships	7,249	(1,204)	6,045	7,114	(645)	6,469
	$ 15,538	$ (3,070)	$ 12,468	$ 15,204	$ (2,092)	$ 13,112

Amortization expense of $1.0 million and $0.7 million related to intangible assets was recorded in General and administrative expenses for the nine months ended September 30, 2019 and 2018, respectively.

Note 8 — Loan Agreement

Lawson Loan Agreement

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

On September 30, 2019, credit available under the Loan Agreement, as amended, was 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 were 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 was secured by a first priority perfected security interest in substantially all existing assets of the Company. Dividends were restricted to amounts not to exceed $7.0 million annually.

At September 30, 2019, the Company had $1.3 million of borrowings under its revolving line of credit facility. The Company paid interest of $0.5 million and $0.8 million for the nine months ended September 30, 2019 and 2018, respectively. The weighted average interest rate was 4.54% and 3.82% for the nine months ended September 30, 2019 and 2018, respectively.

Commitment Letter

Bolt Supply had a Commitment Letter with BMO Bank of Montreal ("BMO") dated March 30, 2017 which allowed 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 was cancellable at any time at BMOs sole discretion and was secured by substantially all of Bolt Supply’s assets. It carried an interest rate of the bank's prime rate plus 0.25%. At September 30, 2019, Bolt Supply had $1.2 million Canadian dollars of outstanding borrowings.

As of September 30, 2019, the Company was in compliance with its required debt covenants.

New Credit Agreement

Subsequent to the end of the third quarter, on October 11, 2019, the Company entered into a new five-year credit agreement led by J.P. Morgan Chase Bank N.A, as administrative agent and including CIBC Bank USA and Bank of America, N.A. as other lenders. The new credit agreement matures on October 11, 2024 and provides for $100.0 million of revolving commitments. The new credit agreement allows borrowing capacity to increase to $150.0 million subject to meeting certain criteria and additional commitments from its lenders.

Along with certain standard terms and conditions of the new credit agreement, the Company is able to borrow up to a maximum ratio of its EBITDA to net borrowings of 3.25 times, as defined, and a minimum fixed charge ratio, as defined, of 1.15. On October 11, 2019, the Company paid off its previous loans to CIBC Bank USA and BMO.

Note 9 - Treasury Stock Repurchase Program

In the second quarter of 2019, our Board of Directors authorized a program in which the Company may repurchase up to $7.5 million of the Company's common stock from time to time in open market transactions, privately negotiated transactions or by other methods. In the third quarter of 2019 the Company purchased 32,362 shares of common stock at an average purchase price of $38.13 under the repurchase program.

Note 10 — Severance Reserve

Changes in the Company’s reserve for severance as of September 30, 2019 and 2018 were as follows:

	(Dollars in thousands) Nine Months Ended September 30,	
	2019	2018
Balance at beginning of period	$ 359	$ 483
Charged to earnings	1,542	723
Payments	(925)	(787)
Balance at end of period	$ 976	$ 419

Note 11 — Stock-Based Compensation

The Company recorded stock-based compensation expense of $7.6 million and $8.7 million for the first nine months of 2019 and 2018, 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 issued during the nine months ended September 30, 2019 follows:

Stock Performance Rights ("SPRs")

The Company issued 26,825 SPRs to key employees with an exercise price of $30.78 per share that cliff vest on December 31, 2021 and have a termination date of December 31, 2026. SPRs entitle the recipient to receive a cash payment equal to the excess of the market value of the Company's common stock over the SPR exercise price when the SPRs are surrendered.

Restricted Stock Units ("RSUs")

The Company issued 10,045 RSUs to certain members of the Company's Board of Directors with a vesting date of May 14, 2020. The Company issued 17,340 RSUs to key employees that cliff vest on December 31, 2021. Each RSU 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 41,219 MSUs to key employees that cliff vest on December 31, 2021. 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 61,829, will be determined based upon the trailing sixty-day weighted average closing price of the Company's common stock on December 31, 2021.

No stock options were excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2019. 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 of the Company's common stock were excluded from the computation of diluted earnings per share because they were 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.

Note 12 — Income Taxes

The Company recorded income tax expense of $3.7 million, a 26.6% effective tax rate for the nine months ended September 30, 2019. The effective tax rate is higher than the U.S. statutory rate due primarily to state taxes, income in higher tax jurisdictions and an inclusion for global intangible low taxed income. Income tax expense of $0.4 million, a 10.8% effective tax rate was recorded for the nine months ended September 30, 2018. The lower rate in the previous year is due mainly to the finalization of the Company's calculation for previously untaxed foreign earnings and profits as a result of the 2017 Tax Cuts and Jobs Act. Cash paid for income taxes was $0.5 million and $1.1 million in the first nine months of 2019 and 2018, respectively.

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, 2019, the Company is subject to U.S. Federal income tax examinations for the years 2016 through 2018 and income tax examinations from various other jurisdictions for the years 2012 through 2018.

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 13 — 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.

The remediation plan was approved by ADEM in 2018. The plan consists of chemical injections throughout the affected area, as well as subsequent monitoring of the area for three consecutive periods. The injection process was completed in the first quarter of 2019 and the environmental consulting firm is monitoring the affected area. The Company made payments of $1.3 million in the first three quarters of 2019 for services rendered by the environmental consulting firm. These payments were applied to the previously accrued environmental remediation liability. The Company believes the remaining environmental remediation liability of approximately $0.1 million, classified within Accrued expenses and other liabilities on the accompanying Consolidated Balance Sheet, will be sufficient to cover the remaining cost of the plan. The Company does not expect to capitalize any amounts related to the remediation plan.

Note 14 — Acquisition

The Company completed the acquisition of Screw Products, Inc. in October 2018 for approximately $5.2 million. The purchase price was funded with cash on hand and utilization of the Company's existing credit facility. Screw Products, Inc. is a distributor of bulk industrial products to large manufacturers and job shops. The Company allocated $2.6 million of the purchase price to an intangible asset for customer relationships and $0.5 million for intangible asset for trade names. These amounts were determined by a third party valuation firm with estimated useful lives of 10 and 15 years, respectively. The excess of the purchase price over the fair values of the identifiable assets and liabilities was recorded as goodwill and represents the expected future benefit to the Company from the acquisition of Screw Products. The Company's Lawson operating segment includes revenues of approximately $0.6 million and $2.1 million from Screw Products in the three and nine months ended September 30, 2019 respectively.

The following table contains unaudited pro forma revenue and net income for Lawson Products assuming the Screw Products acquisition closed on January 1, 2018.

	(Dollars in thousands)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenue				
Actual	$ 94,779	$ 88,530	$ 282,219	$ 263,371
Pro forma	94,779	89,181	282,219	265,650
Net income				
Actual	$ 4,774	$ (816)	$ 10,227	$ 3,614
Pro forma	4,774	(607)	10,227	4,025

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 Screw Products had closed on January 1, 2018 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.

Note 15 – Segment Information

The Company operates in two reportable segments. The businesses have been 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 14 branches in operation at the end of the third quarter of 2019.

Financial information for the Company's reportable segments follows:

	(Dollars in thousands)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Revenue				
Lawson product revenue	$ 73,122	$ 68,539	$ 221,027	$ 206,108
Lawson service revenue	10,339	10,153	29,868	29,627
Total Lawson revenue	83,461	78,692	250,895	235,735
Bolt Supply	11,318	9,838	31,324	27,636
Consolidated total	$ 94,779	$ 88,530	$ 282,219	$ 263,371
Gross profit				
Lawson product gross profit	$ 40,379	$ 37,742	$ 122,113	$ 113,291
Lawson service gross profit	5,769	6,710	16,411	19,380
Total Lawson gross profit	46,148	44,452	138,524	132,671
Bolt Supply	4,426	3,656	12,016	10,786
Consolidated total	$ 50,574	$ 48,108	$ 150,540	$ 143,457
Operating income				
Lawson	$ 5,377	$ (2,754)	$ 11,490	$ 3,530
Bolt Supply	1,069	488	2,123	1,595
Consolidated total	6,446	(2,266)	13,613	5,125
Interest expense	(138)	(251)	(481)	(755)
Other income (expense), net	(13)	170	798	(320)
Income (loss) before income taxes	$ 6,295	$ (2,347)	$ 13,930	$ 4,050

Note 16 - Subsequent Event

Subsequent to the end of the third quarter, on October 11, 2019, the Company entered into a new five year credit agreement led by J.P. Morgan Chase Bank N.A, as administrative agent and including CIBC Bank USA and Bank of America, N.A. that transitioned our existing borrowing under an asset-based lending arrangement to a cash flow structure. The new Credit Agreement matures on October 11, 2024 and increases the committed borrowing level from $40.0 million to $100.0 million. The new credit agreement allows borrowing capacity to increase to $150.0 million subject to meeting certain criteria and additional commitments from its lenders.

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 49.4 in the third quarter of 2019 compared to 59.6 in the third quarter of 2018, indicating a slight contraction in the U.S. manufacturing economy in the current quarter compared to an expansion in the U.S. manufacturing economy a year ago.

Our sales are also affected by the number of sales representatives and their productivity. Our sales force increased to an average of 989 sales representatives in the third quarter of 2019 from 967 sales representatives during the third quarter of 2018. Our Lawson segment sales representative productivity, measured as sales per rep per day, increased 1.3% to $1,309 in the third quarter of 2019 from $1,292 in the third quarter of 2018. Sales in 2019 also benefited from the acquisition of Screw Products, Inc. ("Screw Products") in the fourth quarter of 2018. We anticipate the size of our sales force to remain relatively stable for the remainder of 2019 as we concentrate our efforts on providing training and support to continue to increase the productivity of our existing sales representatives.

Quarter ended September 30, 2019 compared to quarter ended September 30, 2018

	2019		2018	
(Dollars in thousands)	Amount	% of Net Sales	Amount	% of Net Sales
Revenue	$ 94,779	100.0 %	$ 88,530	100.0 %
Cost of goods sold	44,205	46.6 %	40,422	45.7 %
Gross profit	50,574	53.4 %	48,108	54.3 %
Operating expenses:				
Selling expenses	21,255	22.4 %	22,175	25.0 %
General and administrative expenses	22,873	24.2 %	28,199	31.9 %
Total operating expenses	44,128	46.6 %	50,374	56.9 %
Operating income (loss)	6,446	6.8 %	(2,266)	(2.6)%
Interest expense	(138)	(0.1)%	(251)	(0.3)%
Other (expense) income, net	(13)	(0.1)%	170	0.2 %
Income (loss) before income taxes	6,295	6.6 %	(2,347)	(2.7)%
Income tax expense (benefit)	1,521	1.6 %	(1,531)	(1.8)%
Net income (loss)	$ 4,774	5.0 %	$ (816)	(0.9)%

Revenue and Gross Profits

(Dollars in thousands)	Three Months Ended September 30, 2019	2018	Increase Amount	%
Revenue				
Lawson	$ 83,461	$ 78,692	$ 4,769	6.1%
Bolt Supply	11,318	9,838	1,480	15.0%
Consolidated	$ 94,779	$ 88,530	$ 6,249	7.1%
Gross profit				
Lawson	$ 46,148	$ 44,452	$ 1,696	3.8%
Bolt Supply	4,426	3,656	770	21.1%
Consolidated	$ 50,574	$ 48,108	$ 2,466	5.1%
Gross profit margin				
Lawson	55.3%	56.5%		
Bolt Supply	39.1%	37.2%		
Consolidated	53.4%	54.3%		

Total sales increased 7.1% to $94.8 million in the third quarter of 2019 compared to $88.5 million in the third quarter of 2018. The Lawson segment total sales were positively impacted by a 1.3% improvement in sales productivity of Lawson sales representatives and growth in our strategic, Kent Automotive, government, and core businesses. A 15.0% improvement in Bolt Supply sales spread across multiple product categories and the inclusion of Screw Products sales of $0.6 million, which was acquired in the fourth quarter of 2018, also contributed to the increase. Average daily sales grew to $1.481 million in the third quarter of 2019 compared to $1.405 million in the prior year quarter. The third quarter 2019 had one more selling day compared to the third quarter 2018. Excluding the impact of currency fluctuations, consolidated sales increased 7.4% for the quarter.

Gross Profit

Gross profit increased $2.5 million to $50.6 million in the third quarter of 2019 compared to $48.1 million in the third quarter of 2018, primarily driven by increased sales, partially offset by an increase of service-related costs. Consolidated gross profit as a percent of sales was 53.4% compared to 54.3% a year ago. Lower gross margin profiles on both the Bolt Supply and Screw Products businesses drove the lower consolidated percentage. The organic Lawson MRO segment gross margin as a percent of sales of 60.9% in the third quarter 2019, was flat compared to a year ago quarter before giving effect to the service-related costs.

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Selling, General and Administrative Expenses

(Dollars in thousands)	Three Months Ended September 30, 2019	2018	Increase (Decrease) Amount	%
Selling expenses				
Lawson	$ 20,402	$ 21,372	$ (970)	(4.5)%
Bolt Supply	853	803	50	6.2%
Consolidated	$ 21,255	$ 22,175	$ (920)	(4.1)%
General and administrative expenses				
Lawson	$ 20,369	$ 25,834	$ (5,465)	(21.2)%
Bolt Supply	2,504	2,365	139	5.9%
Consolidated	$ 22,873	$ 28,199	$ (5,326)	(18.9)%

Selling expenses consist of compensation and support for our sales representatives. Selling expenses were $21.3 million in the third quarter of 2019 compared to $22.2 million in the prior year quarter and, as a percent of sales, decreased to 22.4% from 25.0% in the third quarter of 2018. The decrease in selling expense as a percent of sales compared to the prior year quarter is primarily due to leveraging selling expenses over a higher sales base and an increase in service-related costs included in gross margin.

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses decreased to $22.9 million in the third quarter of 2019 from $28.2 million in the prior year quarter. The lower general and administrative expense was primarily driven by a decrease of $5.3 million of stock based compensation expense, of which a portion fluctuates with the Company's stock price, compared to the prior year quarter.

Interest Expense

Interest expense decreased to $0.1 million compared to $0.3 million in the third quarter of 2019 and 2018 as a result of lower outstanding borrowing levels.

Other Income (Expense), Net

Other income (expense), net increased $0.2 million in the third quarter of 2019 over the prior year quarter primarily due to Canadian currency exchange rate effect.

Income Tax Expense

Income tax expense was $1.5 million, resulting in a 24.2% effective tax rate for the three months ended September 30, 2019 compared to an income tax benefit of $1.5 million and an effective tax rate of 65.2% for the three months ended September 30, 2018. The decrease in the effective tax rate as compared to a year ago is primarily due to the finalization of the calculation for previously untaxed foreign earnings and profits as a result of the 2017 Tax Cuts and Jobs Act.

Nine months ended September 30, 2019 compared to September 30, 2018

($ in thousands)	2019 Amount	2019 % of Net Sales	2018 Amount	2018 % of Net Sales
Revenue	$ 282,219	100.0 %	$ 263,371	100.0 %
Cost of goods sold	131,679	46.7 %	119,914	45.5 %
Gross profit	150,540	53.3 %	143,457	54.5 %
Operating expenses:				
Selling expenses	64,864	23.0 %	66,119	25.1 %
General and administrative expenses	72,063	25.5 %	72,213	27.5 %
Total operating expenses	136,927	48.5 %	138,332	52.6 %
Operating income	13,613	4.8 %	5,125	1.9 %
Interest expense	(481)	(0.2)%	(755)	(0.3)%
Other income (expense), net	798	0.3 %	(320)	(0.1)%
Income before income taxes	13,930	4.9 %	4,050	1.5 %
Income tax expense	3,703	1.3 %	436	0.1 %
Net income	$ 10,227	3.6 %	$ 3,614	1.4 %

Revenue and Gross Profit

(Dollars in thousands)	Nine Months Ended September 30, 2019	Nine Months Ended September 30, 2018	Increase Amount	Increase %
Revenue				
Lawson	$ 250,895	$ 235,735	$ 15,160	6.4%
Bolt Supply	31,324	27,636	3,688	13.3%
Consolidated	$ 282,219	$ 263,371	$ 18,848	7.2%
Gross profit				
Lawson	$ 138,524	$ 132,671	$ 5,853	4.4%
Bolt Supply	12,016	10,786	1,230	11.4%
Consolidated	$ 150,540	$ 143,457	$ 7,083	4.9%
Gross profit margin				
Lawson	55.2%	56.3%		
Bolt Supply	38.4%	39.0%		
Consolidated	53.3%	54.5%		

Revenue

Revenue for the nine months ended September 30, 2019 increased 7.2% to $282.2 million from $263.4 million for the nine months ended September 30, 2018. The Lawson segment total sales were positively impacted by a 2.9% improvement in sales productivity of Lawson sales representatives and strong performance in our sales to Government customers. A 13.3% improvement in Bolt Supply sales spread across multiple product categories and the inclusion of Screw Products sales of $2.1 million which was acquired in the fourth quarter of 2018, also contributed to the increase. Average daily sales improved 6.6% to $1.478 million in the first nine months of 2019 compared to $1.386 million in the prior year period with one more selling day in the and in the nine months ended September 30, 2019 compared to the prior year period. Excluding the impact of currency fluctuations, consolidated sales increased 7.9% for the year to date.

Gross Profit

Gross profit increased to $150.5 million in the first nine months of 2019 compared to $143.5 million in the first nine months of 2018, primarily driven by increased sales. Consolidated gross profit as a percent of sales was 53.3% compared to 54.5% a year ago. Higher service-related costs and lower gross margin as a percent of sales on both the Bolt Supply and Screw Products businesses drove the lower consolidated percentage. Excluding these businesses, the core Lawson MRO segment gross margin as a percent of sales was 60.7% in the first nine months of 2019 compared to 60.6% a year ago before the effect of the allocated service costs.

Selling, General and Administrative Expenses

	Nine Months Ended September 30,		Increase (Decrease)	
(Dollars in thousands)	2019	2018	Amount	%
Selling expenses				
Lawson	$ 62,334	$ 63,870	$ (1,536)	(2.4)%
Bolt Supply	2,530	2,249	281	12.5%
Consolidated	$ 64,864	$ 66,119	$ (1,255)	(1.9)%
General and administrative expenses				
Lawson	$ 64,700	$ 65,271	$ (571)	(0.9)%
Bolt Supply	7,363	6,942	421	6.1%
Consolidated	$ 72,063	$ 72,213	$ (150)	(0.2)%

Selling expenses decreased to $64.9 million for the first nine months of 2019 from $66.1 million in the first nine months of 2018 and, as a percent of sales, decreased to 23.0% in the first nine months of 2019 from 25.1% a year ago. The decrease in selling expense as a percent of sales is primarily due to leveraging selling expenses over a higher sales base and higher service-related costs included in gross margins.

General and administrative expenses decreased slightly to $72.1 million in the first nine months of 2019 from $72.2 million in the prior year period primarily due to a decrease in stock-based compensation expense of $1.1 million, a portion of which varies with the company stock price, offset by increased severance expense of $0.8 million compared to the prior year to date.

Interest Expense

Interest expenses decreased $0.3 million in the first nine months of 2019, due primarily to decreased average outstanding borrowings compared to the prior year.

Other Income (Expense), Net

Other income (expense), net increased $1.1 million in the first nine months of 2019, primarily due to Canadian currency exchange rate effect.

Income Tax Expense

Income tax expenses were $3.7 million resulting in a 26.6% effective tax rate for the first nine months of 2019 compared to income tax expense of $0.4 million and a 10.8% effective tax rate for the first nine months of 2018. The decrease in the effective tax rate as compared to a year ago is primarily due to the finalization of the calculation for previously untaxed foreign earnings and profits as a result of the 2017 Tax Cuts and Jobs Act.

Liquidity and Capital Resources

Available cash and cash equivalents were $8.6 million on September 30, 2019 compared to $11.9 million on December 31, 2018. Net cash generated from operations were $8.0 million and $10.3 million for the nine months ended September 30, 2019 and 2018, respectively. Cash generated by operating earnings was partially offset by an increase in accounts receivable, primarily to support the increase in sales, and payments primarily for incentives, environmental remediation and other accruals that existed at December 31, 2018.

Capital expenditures, primarily for improvements to our distribution centers and information technology, were $1.4 million and $1.6 million for the nine month periods ended September 30, 2019 and 2018, respectively.

The Company used $10.2 million in financing activities in the first nine months of 2019 primarily through a net paydown on its revolving lines of credit and the repurchase of its shares.

In the second quarter of 2019, our Board of Directors authorized a program in which we may repurchase up to $7.5 million of our common stock from time to time in open market transactions, privately negotiated transactions or by other methods. In the third quarter of 2019 we purchased 32,362 shares of our common stock at an average purchase price of $38.13, primarily under the repurchase program.

Lawson Loan Agreements

On September 30, 2019, we had $1.3 million of borrowings under the existing revolving line of credit facility. No dividends were paid to shareholders in the nine months ended September 30, 2019 and 2018.

In addition to other customary representations, warranties and covenants, if the excess borrowing capacity under our revolving line of credit facility was below $10.0 million, we were required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement. On September 30, 2019, 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	5.92 : 1.00

As of September 30, 2019, Lawson Products was in compliance with all covenants.

Bolt Commitment Letter

At September 30, 2019, Bolt had $1.2 million Canadian dollars of outstanding borrowings under a Commitment Letter. The Commitment Letter is subject to a working capital requirement 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 of 1.25:1 as defined in the Commitment Letter. At September 30, 2019, Bolt was in compliance with all covenants.

New Credit Agreement

On October 11, 2019, the Company entered into a new five year credit agreement led by J.P. Morgan Chase Bank N.A, as administrative agent and including CIBC Bank USA and Bank of America, N.A. as other lenders. The new Credit Agreement matures on October 11, 2024 and provides for $100.0 million of revolving commitments. The new credit agreement allows borrowing capacity to increase to $150.0 million subject to meeting certain criteria and additional commitments from its lenders.

Along with certain standard terms and conditions of the new credit agreement, the Company is able to borrow up to a maximum ratio of its EBITDA to net borrowings of 3.25 times, as defined, and a minimum fixed charge ratio, as defined, of 1.15. On October 11, 2019, the Company paid off its previous loans to CIBC Bank USA and BMO.

We believe cash provided by operations and funds available under our new credit agreement are sufficient to fund our operating requirements, strategic initiatives and capital improvements for the next 12 months. While we were in compliance with the financial covenant for the quarter ended September 30, 2019, failure to meet the covenant requirements of the new credit agreement 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 3 of Part I is inapplicable and has been omitted from this report.

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, 2019 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

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

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

The following table summarizes the repurchases of the Company's common stock for the three months ended September 30, 2019.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 to July 31, 2019 [(1)]	3,468	$ 36.66	—	$ 7,500,000
August 1 to August 31, 2019 [(2)]	32,362	38.13	32,362	6,266,037
September 1 to September 30, 2019	—	—	—	6,266,037
Total	35,830		32,362	

(1) Shares were repurchased for the sole purpose of satisfying tax withholding obligations of certain individuals upon the vesting of restricted stock awards granted to them by the Company. These shares were not repurchased in the open market.

(2) Shares were purchased on the open market under the Company's stock repurchase program approved in the second quarter of 2019 which authorized the Company to purchase $7.5 million of the Company's common stock.

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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

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 24, 2019	/s/ Michael G. DeCata
		Michael G. DeCata President and Chief Executive Officer (principal executive officer)
Dated:	October 24, 2019	/s/ Ronald J. Knutson
		Ronald J. Knutson Executive Vice President, Chief Financial Officer, Treasurer and Controller (principal financial and accounting officer)

Exhibit 31.1

CERTIFICATION

I, Michael G. DeCata, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lawson Products, Inc. (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal nine months (the registrant’s fourth fiscal nine months in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

    (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

    (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 24, 2019

/s/ Michael G. DeCata
Michael G. DeCata
President and Chief Executive Officer
(principal executive officer)

Exhibit 31.2

CERTIFICATION

I, Ronald J. Knutson, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lawson Products, Inc. (the “registrant”);

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal nine months (the registrant’s fourth fiscal nine months in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: October 24, 2019

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

Exhibit 32

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Lawson Products, Inc. (the “Company”) on Form 10-Q for the period ending September 30, 2019 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that based on their knowledge: (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

October 24, 2019

/s/ Michael G. DeCata
Michael G. DeCata
Lawson Products, Inc.
President and Chief Executive Officer
(principal executive officer)

/s/ Ronald J. Knutson
Ronald J. Knutson
Lawson Products, Inc.
Executive Vice President, Chief Financial Officer,
Treasurer and Controller
(principal financial and accounting officer)