

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

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**FORM 10-Q**

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(Mark One)

**Quarterly Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934**  
For quarterly period ended **September 30, 2016**  
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**

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**LAWSON PRODUCTS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**36-2229304**  
(I.R.S. Employer  
Identification No.)

**8770 W. Bryn Mawr Avenue, Suite 900, Chicago, Illinois**  
(Address of principal executive offices)

**60631**  
(Zip Code)

**(773) 304-5050**  
(Registrant's telephone number, including area code)

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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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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 14, 2016 was 8,798,273.

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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 of management to successfully implement strategic initiatives;
- 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, 2015.

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, 2016	December 31, 2015
<b>ASSETS</b>		
(Unaudited)		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 10,657	\$ 10,765
Restricted cash	800	800
Accounts receivable, less allowance for doubtful accounts	31,637	27,231
Inventories, net	41,347	44,095
Miscellaneous receivables and prepaid expenses	4,292	3,667
<b>Total current assets</b>	<b>88,733</b>	<b>86,558</b>
Property, plant and equipment, net	31,989	35,487
Cash value of life insurance	9,985	10,245
Goodwill	2,074	319
Deferred income taxes	51	51
Other assets	1,024	434
<b>Total assets</b>	<b>\$ 133,856</b>	<b>\$ 133,094</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Revolving line of credit	\$ —	\$ 925
Accounts payable	11,340	9,370
Accrued expenses and other liabilities	21,378	26,048
<b>Total current liabilities</b>	<b>32,718</b>	<b>36,343</b>
Security bonus plan	14,321	14,641
Financing lease obligation	7,812	8,539
Deferred compensation	4,832	4,626
Deferred rent liability	3,803	3,912
Other liabilities	4,430	3,769
<b>Total liabilities</b>	<b>67,916</b>	<b>71,830</b>
<b>Stockholders' equity:</b>		
Preferred stock, \$1 par value:		
Authorized - 500,000 shares, Issued and outstanding — None	—	—
Common stock, \$1 par value:		
Authorized - 35,000,000 shares		
Issued - 8,824,385 and 8,796,264 shares, respectively		
Outstanding - 8,798,273 and 8,771,120 shares, respectively	8,824	8,796
Capital in excess of par value	10,765	9,877
Retained earnings	46,586	43,572
Treasury stock – 26,112 and 25,144 shares, respectively	(533)	(515)
Accumulated other comprehensive income	298	(466)
<b>Total stockholders' equity</b>	<b>65,940</b>	<b>61,264</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 133,856</b>	<b>\$ 133,094</b>

See notes to condensed consolidated financial statements.

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

	Three months ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	\$ 70,199	\$ 70,243	\$ 209,258	\$ 210,873
Cost of goods sold	27,626	26,901	81,700	80,840
<b>Gross profit</b>	<b>42,573</b>	<b>43,342</b>	<b>127,558</b>	<b>130,033</b>
<b>Operating expenses:</b>				
Selling expenses	23,568	22,240	69,525	68,590
General and administrative expenses	16,616	18,292	54,446	56,337
Operating expenses	40,184	40,532	123,971	124,927
<b>Operating income</b>	<b>2,389</b>	<b>2,810</b>	<b>3,587</b>	<b>5,106</b>
Interest expense	(167)	(131)	(486)	(409)
Other income (expenses), net	66	(1)	439	(210)
<b>Income before income taxes</b>	<b>2,288</b>	<b>2,678</b>	<b>3,540</b>	<b>4,487</b>
Income tax expense	463	248	526	502
<b>Net income</b>	<b>\$ 1,825</b>	<b>\$ 2,430</b>	<b>\$ 3,014</b>	<b>\$ 3,985</b>
<b>Basic income per share of common stock</b>	<b>\$ 0.21</b>	<b>\$ 0.28</b>	<b>\$ 0.34</b>	<b>\$ 0.46</b>
<b>Diluted income per share of common stock</b>	<b>\$ 0.20</b>	<b>\$ 0.27</b>	<b>\$ 0.34</b>	<b>\$ 0.45</b>
<b>Weighted average shares outstanding:</b>				
Basic weighted average shares outstanding	8,785	8,746	8,778	8,725
Effect of dilutive securities outstanding	141	144	139	149
Diluted weighted average shares outstanding	8,926	8,890	8,917	8,874
<b>Comprehensive income</b>				
Net income	\$ 1,825	\$ 2,430	\$ 3,014	\$ 3,985
Other comprehensive loss, net of tax				
Adjustment for foreign currency translation	(33)	(740)	764	(1,162)
<b>Net comprehensive income</b>	<b>\$ 1,792</b>	<b>\$ 1,690</b>	<b>\$ 3,778</b>	<b>\$ 2,823</b>

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,	
	2016	2015
<b>Operating activities:</b>		
Net income	\$ 3,014	\$ 3,985
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,386	6,341
Stock-based compensation	(1,332)	400
Changes in operating assets and liabilities:		
Accounts receivable	(4,547)	(762)
Inventories	3,209	1,457
Prepaid expenses and other assets	(388)	(823)
Accounts payable and other liabilities	(1,345)	(4,727)
Other	300	336
<b>Net cash provided by operating activities</b>	<b>\$ 5,297</b>	<b>\$ 6,207</b>
<b>Investing activities:</b>		
Additions to property, plant and equipment	\$ (2,572)	\$ (1,900)
Business acquisitions	(2,576)	(441)
Proceeds from sale of property and equipment	—	3
<b>Net cash used in investing activities</b>	<b>\$ (5,148)</b>	<b>\$ (2,338)</b>
<b>Financing activities:</b>		
Net payments on revolving line of credit	\$ (925)	\$ —
Proceeds from stock option exercises	—	50
<b>Net cash (used in) provided by financing activities</b>	<b>\$ (925)</b>	<b>\$ 50</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>668</b>	<b>(346)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(108)</b>	<b>3,573</b>
Cash and cash equivalents at beginning of period	10,765	4,207
<b>Cash and cash equivalents at end of period</b>	<b>\$ 10,657</b>	<b>\$ 7,780</b>

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, 2015. 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, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. Certain reclassifications have been made to the Condensed Consolidated Financial Statements for September 30, 2015 to conform to current period presentation.

The Company operates in one reportable segment as a Maintenance, Repair and Operations ("MRO") distributor of products and services to the industrial, commercial, institutional, and governmental maintenance, repair and operations marketplace.

For the three and nine months ended September 30, 2016 and 2015, stock options to purchase 40,000 of the Company's common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive.

There have been no material changes in the Company's significant accounting policies during the nine months ended September 30, 2016 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2015.

**Note 2 — 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 3 — Inventories, net**

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

	(Dollars in thousands)	
	September 30, 2016	December 31, 2015
Inventories, gross	\$ 46,689	\$ 49,615
Reserve for obsolete and excess inventory	(5,342)	(5,520)
Inventories, net	<u>\$ 41,347</u>	<u>\$ 44,095</u>

**Note 4 — Acquisition and Goodwill**

In the nine months of 2016, the Company acquired the assets of Perfect Products Company of Michigan, an auto parts distributor for approximately \$1.3 million in cash and \$30 thousand in contingent consideration. The Company also acquired the assets of F.B. Feeney Hardware in Ontario, Canada, for approximately \$1.3 million in cash and \$84 thousand in contingent consideration. Total contingent consideration of \$114 thousand was not reflected in the condensed consolidated statement of cash flows.

These transactions resulted in additional goodwill which is included in the table below:

	(Dollars in thousands)	
	Nine Months Ended September 30, 2016	
Goodwill		
Beginning balance	\$	319
Acquisitions		1,762
Impact of foreign exchange		(7)
Ending balance	\$	2,074

Additionally, \$0.7 million of the purchase price related to customer relationships was allocated to an intangible asset included in Other assets in the Condensed Consolidated Balance Sheets which will be amortized over 5 years. The preliminary allocation of the purchase price and resulting preliminary goodwill is subject to finalizing the valuation of certain assets.

**Note 5 — 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 were revised in December 2013, by a Second Amendment to Loan and Security Agreement ("Second Amendment") and in September 2016, by a Sixth Amendment to Loan and Security Agreement ("Sixth Amendment"). 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:

- 85% of the face amount of the Company’s eligible accounts receivable, generally less than 60 days past due, and
- 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, 2016, the Company had no borrowings under its revolving line of credit facility and additional borrowing availability of \$34.8 million. The Company paid interest of \$0.5 million and \$0.4 million for the nine months ended September 30, 2016 and 2015, respectively. The weighted average interest rate was 3.5% for the nine months ended September 30, 2016.

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, and a minimum quarterly tangible net worth level as defined in the amended Loan Agreement, if the excess capacity is below \$10.0 million. On September 30, 2016, the Company's borrowing capacity exceeded \$10.0 million, therefore, the Company was not subject to these financial covenants, however, for informational purposes the results of the financial covenants are provided below:

Quarterly Financial Covenants	Requirement	Actual
EBITDA to fixed charges ratio	1.10 : 1.00	2.07 : 1.00
Minimum tangible net worth	\$45.0 million	\$56.2 million



**Note 6 — Severance Reserve**

Changes in the Company's reserve for severance as of September 30, 2016 and 2015 were as follows:

	(Dollars in thousands)	
	Nine Months Ended September 30,	
	2016	2015
Balance at beginning of period	\$ 697	\$ 311
Charged to earnings	714	993
Payments	(950)	(583)
Balance at end of period	\$ 461	\$ 721

**Note 7 — Stock-Based Compensation**

The Company recorded a benefit for stock-based compensation of \$1.3 million for the first nine months of 2016, as a portion of stock-based compensation is related to the market value of the Company's common stock which declined during the period. The Company recorded an expense of \$0.4 million for stock-based compensation for the first nine months of 2015.

A summary of stock-based awards issued during the nine months ended September 30, 2016 follows:

Stock Performance Rights ("SPRs")

The Company issued 53,503 SPRs to key employees with an exercise price of \$18.98 per share that cliff vest on December 31, 2018 and have a termination date of December 31, 2023.

Restricted Stock Units ("RSUs")

The Company issued 28,567 RSUs to the Company's directors with a vesting date of May 17, 2017. 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 74,866 MSUs to key employees that cliff vest on December 31, 2018. 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 112,300, will be determined based upon the trailing sixty-day average closing price of the Company's common stock on December 31, 2018.

**Note 8 — Income Taxes**

Primarily due to the cumulative losses that the Company has incurred over the past three years, the Company has determined that there is insufficient positive evidence to conclude that it is more likely than not that it will be able to utilize its deferred tax assets to offset future taxable income. Therefore, substantially all deferred tax assets are currently subject to a tax valuation allowance. However, sufficient evidence may become available in future periods regarding the utilization of deferred tax assets that would lead to the reduction of all or a portion of the valuation allowance resulting in a decrease to income tax expense for the period in which the reduction is recorded. Although the Company is in this full tax valuation allowance position, a tax expense of \$0.5 million and \$0.5 million was recorded for the nine months ended September 30, 2016 and 2015, respectively, primarily due to reserves for uncertain tax positions net of state tax refunds.

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, 2016, the Company is subject to U.S. Federal income tax examinations for the years 2013 through 2015 and income tax examinations from various other jurisdictions for the years 2006 through 2015. The Company is also subject to an examination by the Canada Revenue Authority ("CRA") for the years 2006 through 2010. The CRA examination was completed during May 2013 and resulted in proposed adjustments which amount to \$1.3 million of additional tax for the 2008 and 2009 tax years. The Company did not agree with these adjustments and filed a request with Competent Authority programs in both the U.S. and Canada in October 2013. The Competent Authority program assists taxpayers with respect to matters covered in the mutual agreement procedure provisions of tax treaties. In the fourth quarter of 2015, Competent Authority completed their review and communicated to the Company that they proposed to assess a tax on the 2009 tax year only.

The Company received and accepted a formal letter of disposition from Competent Authority in the second quarter of 2016. Based on the proposed assessment, in the fourth quarter of 2015 the Company recorded an expense of approximately \$0.8 million in Canada and a related benefit of \$0.5 million in the U.S.

Earnings from the Company's foreign subsidiary are considered to be indefinitely reinvested. A distribution of these non-U.S. earnings in the form of dividends or otherwise would subject the Company to both U.S. Federal and state income taxes, as adjusted for foreign tax credits.

During the first nine months of 2016, as the result of two small acquisitions, the Company recorded \$1.8 million of tax deductible goodwill that may result in a tax benefit in future periods.

#### **Note 9 — 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. In August 2013, the site was enrolled in Alabama's voluntary cleanup program. On October 30, 2014, the Company received estimates from its environmental consulting firm with three potential remediation solutions. The estimates included a range of viable remedial approaches. The first solution included limited excavation and removal of the contaminated soil along with monitoring for a period up to 10 years. The second solution included the first solution plus the installation of a groundwater extraction system. The third scenario included the first and second solutions plus treatment injections to reduce the degradation time. The estimated expenditures over a 10-year period under the three scenarios ranged from \$0.3 million to \$1.4 million, of which up to \$0.3 million may be capitalized. As the Company has determined that a loss was probable, however no scenario was more likely than the other at that time, a liability in the amount of \$0.3 million was established in 2014.

During 2015, after further evidence had been collected and analyzed, the Company concluded that it was probable that future remediation would be required, and accordingly accrued an additional \$0.9 million for the estimated costs. This estimate is based on the information developed to date and as the remediation efforts proceed, additional information may impact the final cost. As of September 30, 2016, agreement with Alabama's voluntary cleanup program on viable treatment of the property has not yet been reached and the Company continues to evaluate potential remediation alternatives that could impact the ultimate cost of remediation. As of September 30, 2016, approximately \$1.1 million was accrued for remediation in other long-term liabilities on the accompanying consolidated balance sheet.

**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 51.2 in the third quarter of 2016 and 51.0 in the third quarter of 2015, indicating modest growth in the U.S. manufacturing economy. The MRO distribution industry continues to experience generally slow growth due to many factors with the most prominent factor negatively impacting Lawson being a slow-down in the oil and gas end markets due to lower oil prices.

Our sales are also affected by the number of sales representatives and the amount of sales which each representative can generate, which we measure as average sales per day per sales representative. As of September 30, 2016, we had a sales force of 1,006 sales representatives, an increase of 81 over the prior year quarter. While we anticipate future sales growth from our expanded sales force, we also anticipate a short-term decrease in average sales per day per sales representative, as new representatives build up customer relationships in their territories. Following the acceleration in the size of our sales force in the first two quarters of 2016, we have moderated the rate of hiring incremental sales representatives in the third quarter, and we anticipate that the pace of growth will be slower in the near future as we concentrate our efforts on providing training and support for our expanded sales force to drive their productivity.

**Quarter ended September 30, 2016 compared to quarter ended September 30, 2015**

(\$ in thousands)	2016		2015	
	Amount	% of Net Sales	Amount	% of Net Sales
Net sales	\$ 70,199	100.0 %	\$ 70,243	100.0 %
Cost of goods sold	27,626	39.4 %	26,901	38.3 %
Gross profit	42,573	60.6 %	43,342	61.7 %
Operating expenses:				
Selling expenses	23,568	33.6 %	22,240	31.7 %
General and administrative expenses	16,616	23.6 %	18,292	26.0 %
Operating expenses	40,184	57.2 %	40,532	57.7 %
Operating income	2,389	3.4 %	2,810	4.0 %
Interest and other expenses, net	(101)	(0.1)%	(132)	(0.2)%
Income before income taxes	2,288	3.3 %	2,678	3.8 %
Income tax expense	463	0.7 %	248	0.3 %
Net income	\$ 1,825	2.6 %	\$ 2,430	3.5 %

### *Net Sales*

Net sales were \$70.2 million for both the third quarter of 2016 and 2015, respectively. Sales generated from the addition of more sales representatives year over year were negatively impacted by a general slow-down in the MRO marketplace, weaker demand from customers operating in the oil and gas industry. Sales to oil and gas customers declined \$0.8 million from the prior year quarter. This was partially offset by an increase in sales by our Kent Automotive and government businesses. The third quarter of both 2016 and 2015 had 64 selling days. Average daily sales were essentially flat at to \$1.097 million in the third quarter of 2016 compared to the prior year quarter.

### *Gross Profit*

Gross profit decreased to \$42.6 million in the third quarter of 2016 compared to \$43.3 million in the third quarter of 2015 and decreased as a percent of sales to 60.6% from 61.7% a year ago. Product margin remained consistent versus a year ago, however, gross profit percentage declined primarily as a result of increased net freight expense, a non-recurring Canadian inventory transfer tax and lower vendor rebates on decreased inventory purchases.

### *Selling Expenses*

Selling expenses consist of compensation paid to our sales representatives and related expenses to support our sales efforts. Selling expenses increased to \$23.6 million in the third quarter of 2016 from \$22.2 million in the prior year quarter and as a percent of sales, increased to 33.6% compared to 31.7% in the third quarter of 2015, primarily related to the increase in the number of sales representatives.

### *General and Administrative Expenses*

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 \$16.6 million in the third quarter of 2016 from \$18.3 million in the prior year quarter due primarily to lower stock-based and performance-based compensation expenses, and our continuing efforts to control costs, which were offset partially offset by increased health insurance claims

### *Interest and Other Expenses, Net*

Interest expense, net was \$0.1 million in both the third quarter of 2016 and 2015, respectively.

### *Income Tax Expense*

Primarily due to historical cumulative losses, all of our deferred tax assets are currently subject to a tax valuation allowance. Although we are in a full tax valuation allowance position, an income tax expense of \$0.5 million and \$0.2 million was recorded in the third quarter of 2016 and 2015, respectively, due to state taxes and reserves for uncertain tax positions.

### *Net Income*

We reported net income of \$1.8 million and \$2.4 million in the third quarter of 2016 and 2015, respectively.

**Nine months ended September 30, 2016 compared to September 30, 2015**

(\$ in thousands)	2016		2015	
	Amount	% of Net Sales	Amount	% of Net Sales
Net sales	\$ 209,258	100.0%	\$ 210,873	100.0 %
Cost of goods sold	81,700	39.0%	80,840	38.3 %
Gross profit	127,558	61.0%	130,033	61.7 %
<b>Operating expenses:</b>				
Selling expenses	69,525	33.2%	68,590	32.5 %
General and administrative expenses	54,446	26.1%	56,337	26.7 %
Operating expenses	123,971	59.3%	124,927	59.2 %
Operating income	3,587	1.7%	5,106	2.4 %
Interest and other expenses, net	(47)	—%	(619)	(0.3)%
Income before income taxes	3,540	1.7%	4,487	2.1 %
Income tax expense	526	0.3%	502	0.2 %
Net income	\$ 3,014	1.4%	\$ 3,985	1.9 %

*Net Sales*

Net sales for the nine months ended September 30, 2016 decreased 0.8% to \$209.3 million from \$210.9 million for the nine months ended September 30, 2015. Sales in the first nine months of 2016 were negatively impacted by a general slow-down in the MRO marketplace, weaker demand from customers operating in the oil and gas industry, a decrease in the Canadian exchange rate and lower productivity from newly hired sales representatives as they build out their territories. Sales to oil and gas customers declined \$2.6 million and total net sales were negatively impacted by the Canadian exchange rate by \$0.8 million compared to the prior year period. This was partially offset by an increase in sales by our Kent Automotive Division and growing existing strategic account relationships. The first nine months of 2016 had 192 selling days compared to 191 in the first nine months of 2015. Average daily sales decreased to \$1.090 million in the first nine months of 2016 compared to \$1.104 million in the prior year period.

*Gross Profit*

Gross profit decreased to \$127.6 million in the first nine months of 2016 compared to \$130.0 million in the first nine months of 2015 and decreased as a percent of sales to 61.0% from 61.7% a year ago. Product margin remained consistent versus a year ago, however, as a result of rebalancing and refining our inventory forecasting process, we incurred additional labor and freight costs during the first nine months of 2016. Additionally, the gross margin percentage was lower due to increased net freight expense and additional labor expenses related to repackaging inventory from acquisitions.

*Selling Expenses*

Selling expenses increased to \$69.5 million or 33.2% as a percent of sales in the first nine months of 2016 from \$68.6 million and 32.5% as a percent of sales in the first nine months of 2015. An increase in expenses related to the increase in the number of sales representatives was somewhat offset by \$1.9 million of expenses related to the North American sales meeting held in 2015 which was not held in 2016.

*General and Administrative Expenses*

General and administrative expenses decreased to \$54.4 million in the first nine months of 2016 from \$56.3 million in the prior year period due as a \$1.7 million decrease in stock-based and performance-based compensation was offset by increased employee and acquisition related costs.

*Interest and Other Expenses, Net*

Interest and other expenses, net improved by \$0.6 million in the first nine months of 2016, mostly due to currency exchange gains in 2016 compared to currency exchange losses in 2015.

*Income Tax Expense*

Primarily due to historical cumulative losses, substantially all of our deferred tax assets are subject to a tax valuation allowance. Although we are in a full tax valuation allowance position, an income tax expense of \$0.5 million was recorded in the first nine months of both 2016 and 2015, primarily due to state taxes and reserves for uncertain tax positions.

*Net Income*

We reported net income of \$3.0 million and \$4.0 million in the first nine months of 2016 and 2015, respectively.

**Liquidity and Capital Resources**

Cash and cash equivalents were \$10.7 million on September 30, 2016 compared to \$10.8 million on December 31, 2015. The net cash provided by operations of \$5.3 million and \$6.2 million in the nine months ended September 30, 2016 and 2015, respectively, was primarily generated by operating earnings and improvements in net working capital.

Capital expenditures, primarily for improvements to our distribution centers and information technology, were \$2.6 million in the nine months ended September 30, 2016 compared to \$1.9 million in the prior year period. In 2016, we invested \$2.6 million in the acquisition of two small MRO distributors.

On September 30, 2016, we had no borrowings on our revolving line of credit and no dividends were paid to shareholders in the nine months ended September 30, 2016 and 2015. Dividends are currently restricted under the Loan Agreement to amounts not to exceed \$7.0 million annually.

*Loan Agreement*

In the third quarter of 2016, we entered into a Sixth Amendment to the Loan Agreement that extended the maturity date to August 8, 2020. We also received an increase in the credit available under the Loan Agreement from 80% to 85% of our eligible accounts receivable, as defined in the Sixth Amendment, and from 50% to 60% of our eligible inventory, as defined in the Sixth Amendment, up to the facility limit of \$40.0 million.

At September 30, 2016, we had additional borrowing availability of \$34.8 million. We believe cash provided by operations and funds available under our Loan Agreement are sufficient to fund our operating requirements, strategic initiatives and capital improvements throughout the remainder of 2016.

In addition to other customary representations, warranties and covenants, we are required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement, and a minimum quarterly tangible net worth level as defined in the amended Loan Agreement, if the excess capacity is below \$10.0 million. On September 30, 2016, our borrowing capacity exceeded \$10.0 million, therefore, we were not subject to these financial covenants, however, for informational purposes we have provided the results of the financial covenants below:

Quarterly Financial Covenants	Requirement	Actual
EBITDA to fixed charges ratio	1.10 : 1.00	2.07 : 1.00
Minimum tangible net worth	\$45.0 million	\$56.2 million

While we were in compliance with the financial covenants for the quarter ended September 30, 2016, failure to meet these covenant requirements 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**

There have been no material changes in market risk at September 30, 2016 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

### **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 (i) the information relating to Lawson, including our consolidated subsidiaries, required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) include, 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, 2016 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**

<b>Exhibit #</b>	
<b>31.1</b>	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
<b>31.2</b>	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
<b>32</b>	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
<b>101.INS</b>	XBRL Instance Document
<b>101.SCH</b>	XBRL Taxonomy Extension Schema Document
<b>101.CAL</b>	XBRL Taxonomy Extension Calculation Linkbase Document
<b>101.DEF</b>	XBRL Taxonomy Extension Definition Linkbase Document
<b>101.LAB</b>	XBRL Taxonomy Extension Label Linkbase Document
<b>101.PRE</b>	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 20, 2016

/s/ Michael G. DeCata

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

Dated: October 20, 2016

/s/ Ronald J. Knutson

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

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 20, 2016

/s/ Michael G. DeCata

Michael G. DeCata

President and Chief Executive Officer

(principal executive officer)

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 20, 2016

/s/ Ronald J. Knutson

Ronald J. Knutson

Executive Vice President, Chief Financial Officer, Treasurer and Controller  
(principal financial and accounting officer)

**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, 2016 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 20, 2016

/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)