SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

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# FORM 10-Q

Quarterly Report under Section 13 or 15(d) of
The Securities Exchange Act of 1934

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For Quarter Ended September 30, 1998 Commission file no. 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.) |

| 1666 East Touhy Avenue, Des Plaines, Illinois | 60018 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

Registrant's telephone no., including area code: (847) 827-9666

Not applicable

Former name, former address and former fiscal year, if changed since last report.

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 X No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. 10,808,322 Shares, $1 par value, as of October 16, 1998.

## LAWSON PRODUCTS, INC. AND SUBSIDIARIES
## CONDENSED CONSOLIDATED BALANCE SHEETS

| (Amounts in thousands, except per share data) | Sept. 30, 1998 (UNAUDITED) | December 31, 1997 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 14,346 | $ 10,248 |
| Marketable securities | 11,576 | 11,638 |
| Accounts receivable, less allowance for doubtful accounts | 35,660 | 33,714 |
| Inventories (Note B) | 44,326 | 41,788 |
| Miscellaneous receivables and prepaid expenses | 8,975 | 5,760 |
| Deferred income taxes | 1,122 | 836 |
| Total Current Assets | 116,005 | 103,984 |
| Marketable securities | 13,207 | 21,713 |
| Property, plant and equipment, less allowances for depreciation and amortization | 40,941 | 40,963 |
| Investments in real estate | 3,878 | 3,731 |
| Deferred income taxes | 5,122 | 4,447 |
| Other assets | 14,871 | 14,136 |
| Total Assets | $ 194,024 | $ 188,974 |

| | | |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | $ 5,781 | $ 4,928 |
| Accrued expenses and other liabilities | 17,860 | 17,902 |
| Income taxes | 1,743 | 1,641 |
| Total Current Liabilities | 25,384 | 24,471 |
| Accrued liability under security bonus plans | 14,808 | 14,000 |
| Other | 10,153 | 10,578 |
| | 24,961 | 24,578 |
| 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 and outstanding - (1998 - 10,853,322 shares; 1997 - 11,135,233 shares) | 10,853 | 11,135 |
| Capital in excess of par value | 763 | 770 |
| Retained earnings | 132,677 | 128,708 |
| Accumulated other comprehensive income | (614) | (688) |
| Total Stockholders' Equity | 143,679 | 139,925 |
| Total Liabilities and Stockholders' Equity | $ 194,024 | $ 188,974 |

See notes to condensed consolidated financial statements.

LAWSON PRODUCTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(Amounts in thousands, except per share data)

| | For the Three Months Ended Sept. 30, | | For the Nine Months Ended Sept. 30, | |
|---|---|---|---|---|
| | 1998 | 1997 | 1998 | 1997 |
| Net sales | $75,530 | $71,420 | $218,427 | $207,693 |
| Investment and other income | 592 | 408 | 1,870 | 1,188 |
| | 76,122 | 71,828 | 220,297 | 208,881 |
| Cost of goods sold (Note B) | 25,941 | 24,331 | 75,645 | 71,167 |
| Selling, general and administrative expenses | 41,043 | 37,453 | 119,520 | 110,258 |
| | 66,984 | 61,784 | 195,165 | 181,425 |
| Income before income taxes | 9,138 | 10,044 | 25,132 | 27,456 |
| Provision for income taxes | 3,884 | 4,165 | 10,627 | 11,206 |
| Net income | $ 5,254 | $ 5,879 | $ 14,505 | $ 16,250 |
| Net income per share of common stock: | | | | |
| Basic | $ 0.48 | $ 0.53 | $ 1.31 | $ 1.46 |
| Diluted | $ 0.48 | $ 0.53 | $ 1.30 | $ 1.45 |
| Cash dividends declared per share of common stock | $ 0.14 | $ 0.14 | $ 0.42 | $ 0.40 |
| Weighted average shares outstanding: | | | | |
| Basic | 11,054 | 11,125 | 11,103 | 11,158 |
| Diluted | 11,057 | 11,157 | 11,125 | 11,174 |

See notes to condensed consolidated financial statements.

LAWSON PRODUCTS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Amounts in thousands)

| | For the Nine Months Ended Sept. 30, 1998 | 1997 |
|---|---|---|
| Operating activities: | | |
| Net income | $ 14,505 | $ 16,250 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 4,196 | 3,746 |
| Changes in operating assets and liabilities | (8,970) | (10,303) |
| Other | (118) | 1,875 |
| Net Cash Provided by Operating Activities | 9,613 | 11,568 |
| Investing activities: | | |
| Additions to property, plant and equipment | (3,949) | (3,886) |
| Purchases of marketable securities | (172,749) | (118,637) |
| Proceeds from sale of marketable securities | 181,418 | 121,302 |
| Other | 629 | 40 |
| Net Cash Provided by/(Used in) Investing Activities | 5,349 | (1,181) |
| Financing activities: | | |
| Purchases of treasury stock | (6,201) | (4,062) |
| Dividends paid | (4,677) | (4,366) |
| Other | 14 | 17 |
| Net Cash Used in Financing Activities | (10,864) | (8,411) |
| Increase in Cash and Cash Equivalents | 4,098 | 1,976 |
| Cash and Cash Equivalents at Beginning of Period | 10,248 | 14,515 |
| Cash and Cash Equivalents at End of Period | $ 14,346 | $ 16,491 |

See notes to condensed consolidated financial statements.

Part I

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

A) As contemplated by the Securities and Exchange Commission, the accompanying consolidated financial statements and footnotes have been condensed and therefore, do not contain all disclosures required by generally accepted accounting principles. Reference should be made to the Company's Annual Report to Stockholders for the year ended December 31, 1997. The Condensed Consolidated Balance Sheet as of September 30, 1998, the Condensed Consolidated Statements of Income for the three and nine month periods ended September 30, 1998 and 1997 and the Condensed Consolidated Statements of Cash Flows for the nine month periods ended September 30, 1998 and 1997 are unaudited. In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) have been made, which 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, 1998 are not necessarily indicative of the results that may be expected for the year ending December 31, 1998.

B) Inventories (consisting of primarily finished goods) at September 30, 1998 and cost of goods sold for the three and nine month periods ended September 30, 1998 and 1997 were determined through the use of estimated gross profit rates.

C) As of January 1, 1998, the Company adopted FASB Statement 130, "Reporting Comprehensive Income," (SFAS 130). SFAS 130 establishes new rules for reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company's net income or stockholders' equity. SFAS 130 requires unrealized gains or losses on the Company's available-for-sale marketable securities and foreign currency translation adjustments to be included in other comprehensive income, which prior to adoption were reported separately in stockholders' equity.

Total comprehensive income and its components, net of related tax, for the first three and nine months of 1998 and 1997 are as follows:

| | Three months ended September 30 | |
|---|---|---|
| | 1998 | 1997 |
| Net income | $5,253,716 | $5,879,218 |
| Unrealized gains(losses) on marketable securities | (43,000) | 63,000 |
| Foreign currency translation adjustments | (279,928) | (99,170) |
| Comprehensive income | $4,930,788 | $5,843,048 |

Part I

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

C) - Continued -

| | Nine months ended September 30 1998 | 1997 |
|---|---|---|
| Net income | $14,505,218 | $16,249,750 |
| Unrealized gains(losses) on marketable securities | 123,000 | (19,000) |
| Foreign currency translation adjustments | (49,977) | (282,363) |
| Comprehensive income | $14,578,241 | $15,948,387 |

The components of accumulated other comprehensive income, net of related tax, at September 30, 1998 and December 31, 1997 are as follows:

| | 1998 | 1997 |
|---|---|---|
| Unrealized gain on marketable securities | $686,000 | $563,000 |
| Foreign currency translation adjustments | (1,300,672) | (1,250,695) |
| Accumulated other comprehensive income | $ (614,672) | $ (687,695) |

In June 1997, the Financial Accounting Standards Board issued Statement of Accounting Standards No. 131, Disclosure about Segments of an Enterprise and Related Information (SFAS 131). SFAS 131 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports. It also establishes standards for related disclosures about products and services, geographic areas and major customers. SFAS 131 is effective for financial statements for fiscal years beginning after December 15, 1997, and therefore the Company will adopt the new requirements retroactively in 1998. Management has not completed its review of SFAS 131, but does not anticipate that the adoption of the statement will have a significant effect on the Company's reported financial disclosures.

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS

D) Earnings per Share

The calculation of dilutive weighted average shares outstanding for the three and nine months ended September 30, 1998 and 1997 are as follows:

| | Three months ended September 30 | |
|---|---|---|
| | 1998 | 1997 |
| Basic weighted average shares outstanding | 11,054,494 | 11,124,852 |
| Dilutive impact of options outstanding | 2,657 | 32,430 |
| Dilutive weighted average shares outstanding | 11,057,151 | 11,157,282 |

| | Nine months ended September 30 | |
|---|---|---|
| | 1998 | 1997 |
| Basic weighted average shares outstanding | 11,103,067 | 11,158,459 |
| Dilutive impact of options outstanding | 22,067 | 15,154 |
| Dilutive weighted average shares outstanding | 11,125,134 | 11,173,613 |

Part I

## Independent Accountants' Review Report

Board of Directors
Lawson Products, Inc.

We have reviewed the accompanying condensed consolidated balance sheet of Lawson Products, Inc. and subsidiaries as of September 30, 1998 and the related condensed consolidated statements of income for the three month and nine month periods ended September 30, 1998 and 1997 and the condensed consolidated statements of cash flows for the nine month periods ended September 30, 1998 and 1997. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of Lawson Products, Inc. as of December 31, 1997, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended, not presented herein, and in our report dated February 27, 1998, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 1997, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

ERNST & YOUNG LLP

October 16, 1998

Part I

This Quarterly Report on Form 10-Q for the quarter ended September 30, 1998, contains certain forward-looking statements pertaining to the Year 2000 Issue and other matters. These statements are subject to uncertainties and other factors which could cause actual events or results to vary materially from those anticipated.

## ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS

Net sales for the three and nine month periods ended September 30, 1998 increased 5.8% to $75,530,000 and 5.2% to $218,427,000 relative to the similar periods of 1997. The sales advances reflect increased contribution from substantially all Lawson operations.

Net income for the third quarter decreased 10.6% to $5,254,000 ($.48 per diluted share) from $5,879,000 ($.53 per diluted share) for the comparable period of 1997. Net income for the nine months ended September 30, 1998 declined 10.7% to $14,505,000 ($1.30 per diluted share) from $16,250,000 ($1.45 per diluted share) for the similar period of 1997. These decreases are primarily attributable to lower gross margins and higher selling costs due to a restructuring of the sales force, which more than offset the gains in net sales noted above. Per share net income was positively impacted by purchases in 1998 and 1997 under the Company's share repurchase program.

Cash flows provided by operations for the nine months ended September 30, 1998 declined to $9,613,000 from $11,568,000 in the comparable period of the prior year. This decrease was due primarily to the decline in net income from the similar period of 1997. Current investments and cash flows from operations are expected to be sufficient to finance the Company's future growth, cash dividends and capital expenditures. Additions to property, plant and equipment were $3,949,000 and $3,886,000, respectively, for the nine months ended September 30, 1998 and 1997. Capital expenditures during 1998 primarily reflect costs incurred relative to the construction of a new Lawson outbound facility in Atlanta, Georgia and purchases of computer related equipment. The new facility, expected to be completed during 1999 at a cost of approximately $7,000,000, will be used in place of the Norcross, Georgia facility, which will be closed. Capital expenditures during 1997 primarily reflect costs incurred for the completion of the facilities expansion at the Company's specialty chemical subsidiary, Drummond American Corporation. This project was completed at a cost of approximately $3,000,000.

During the third quarter of 1998, the Board of Directors authorized the purchase of up to 500,000 shares of the Company's common stock. No shares were purchased relative to the most recent authorization. In 1996, the Board of Directors authorized the purchase of up to 1,000,000 shares of the Company's common stock. During the first nine months of 1998, the Company purchased 282,500 shares at a cost of $6,201,000, while during the first nine months of 1997, the Company expended $4,062,000 to acquire 187,500 shares under the 1996 stock repurchase program. As of September 30, 1998, 762,000 shares have been purchased relative to the 1996 stock repurchase program. All treasury shares purchased as of September 30, 1998 have been retired.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS - continued

The Company has developed a plan to modify its information technology to recognize the Year 2000 Issue. The Year 2000 Issue involves computer programs being written using two digits rather than four to define the applicable year. Computer programs or hardware that have date-sensitive software or embedded chips may recognize a date using "00" as the year 1900 rather than the year 2000, which could result in a system failure or miscalculations causing disruptions in the processing of normal business transactions.

Based on the Company's assessment of the Year 2000 Issue, it has been determined that it will be required to modify or replace portions of its software and certain hardware to insure the proper recognition of dates beyond December 31, 1999. The Company presently believes that with modifications or replacements of certain existing software and hardware, the Year 2000 Issue can be mitigated.

The Company's plan to resolve the Year 2000 Issue involves the following four phases: assessment, remediation, testing, and implementation. The Company has fully completed its assessment of all systems that could be significantly impacted by the Year 2000 and is currently converting its critical data processing systems.

Based on a review of its product line, the Company has determined that the products it has sold and will continue to sell do not require remediation to be Year 2000 compliant. Accordingly, the Company does not believe that the Year 2000 presents exposure as it relates to the Company's products.

The Company has contacted all of its suppliers and has gathered information about their Year 2000 compliance status. To date, the Company is not aware of any supplier with a Year 2000 issue that would have a material impact on the operations of the Company. However, the Company does not have the means to ensure that third parties will be Year 2000 ready. The inability of third parties to complete their Year 2000 resolution process in a timely fashion could materially impact the Company. The effect of non-compliance by third parties is not determinable.

The Company will utilize both internal and external resources to reprogram, or replace, test, and implement the software and operating equipment for Year 2000 modifications. This project remains on schedule, including testing and implementation. The Company presently believes all phases of the conversion will be completed by the second quarter of 1999 at a total cost of approximately $400,000, of which $300,000 of expense has been incurred as of September 30, 1998. This project is not expected to have a significant effect on operations.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS - continued

Although the project is not yet complete, the management of the Company believes it has an effective program in place to resolve the Year 2000 Issue in a timely manner. The Company is committed to providing the necessary resources, including additional funding and manpower, as required, until such time that all phases of the Year 2000 project are completed.

## Part II

## OTHER INFORMATION

Items 1, 2, 3, 4 and 5 are inapplicable and have been omitted from this report.

Item 6. Exhibits and Reports on Form 8-K.

(a) 15 Letter from Ernst & Young LLP Regarding Unaudited Interim Financial Information

27 Financial Data Schedule

(b) The registrant filed a Current Report on Form 8-K August 14, 1998.

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 16, 1998 | /s/ Bernard Kalish<br>Bernard Kalish<br>Chairman of the Board |
| Dated October 16, 1998 | /s/ Joseph L. Pawlick<br>Joseph L. Pawlick<br>Vice President and Controller |

Exhibit 15

Part I

Consent of Independent Auditors

We are aware of the incorporation by reference in the Registration Statement (Form S-8 No. 33-17912 dated November 4, 1987) of Lawson Products, Inc. of our report dated October 16, 1998 relating to the unaudited condensed consolidated interim financial statements of Lawson Products, Inc. which are included in its Form 10-Q for the quarter ended September 30, 1998.

Pursuant to Rule 436(c) of the Securities Act of 1933 our report is not part of the registration statement prepared or certified by accountants within the meaning of Section 7 or 11 of the Securities Act of 1933.

ERNST & YOUNG LLP

Chicago, Illinois
October 16, 1998

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9-MOS
DEC-31-1998
SEP-30-1998
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