LAWSON PRODUCTS INC/NEW/DE/
Form 10-Q
April 30, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
FORM 10-Q

(Mark One)

þ **Quarterly Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934**
For quarterly period ended March 31, 2008

or

o **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.)
1666 East Touhy Avenue, Des Plaines, Illinois	**60018**
(Address of principal executive offices)	(Zip Code)

(847) 827-9666

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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. (Check one):

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

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

The number of shares outstanding of the registrant s common stock, $1 par value, as of April 30, 2008 was 8,522,001.

Table of Contents

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, es expect, intend, objective, plan, potential, project and similar expressions are intended to identify forward-look 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 impact of governmental investigations, such as the recently announced investigation by U.S. Attorney s Office for the Northern District of Illinois; excess and obsolete inventory; disruptions of the Company s information systems; risks of rescheduled or cancelled orders; increases in commodity prices; the influence of controlling stockholders; competition and competitive pricing pressures; the effect of general economic conditions and market conditions in the markets and industries the Company serves; the risks of war, terrorism, and similar hostilities; and, all of the factors discussed in the Company s Risk Factors set forth in its Annual Report on Form 10-K for the year ended December 31, 2007.

The Company undertakes no obligation to update any such factor 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.

TABLE OF CONTENTS

Table of Contents

PART I-FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Lawson Products, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Amounts in thousands, except share and per share data)	March 31, 2008 (UNAUDITED)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,549	$ 1,671
Accounts receivable, less allowance for doubtful accounts	56,888	58,882
Inventories	97,768	96,785
Miscellaneous receivables and prepaid expenses	8,043	10,303
Deferred income taxes	3,010	3,226
Discontinued current assets	1,003	1,064
Total current assets	169,261	171,931
Property, plant and equipment, less accumulated depreciation and amortization	52,158	53,031
Deferred income taxes	20,515	21,344
Goodwill	27,999	27,999
Other assets	24,571	25,558
Total assets	$ 294,504	$ 299,863
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 16,700	$ 16,266
Revolving line of credit	15,500	11,000
Accrued expenses and other liabilities	34,616	45,254
Discontinued current liabilities	333	322
Total current liabilities	67,149	72,842
Accrued liability under security bonus plans	25,993	25,491
Other	24,528	27,169
	50,521	52,660
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 - 8,522,001 shares in 2008 and 2007		8,522		8,522
Capital in excess of par value		4,774		4,774
Retained earnings		163,270		160,606
Accumulated other comprehensive income		268		459
Total stockholders equity		176,834		174,361
Total liabilities and stockholders equity	$	294,504	$	299,863

See notes to condensed consolidated financial statements.

Table of Contents

Lawson Products, Inc. and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)

	For the Three Months Ended March 31,	
(Amounts in thousands, except per share data)	2008	2007
Net sales	$ 125,004	$ 129,669
Cost of goods sold	51,742	53,842
Gross profit	73,262	75,827
Operating expenses:		
Selling, general and administrative expenses	64,713	65,961
Severance and other charges	602	1,721
Operating income	7,947	8,145
Investment and other income	108	102
Interest expense	(229)	(81)
Income from continuing operations before income taxes	7,826	8,166
Income tax expense	3,302	3,440
Income from continuing operations	4,524	4,726
Loss from discontinued operations, net of income taxes	(155)	(156)
Net income	$ 4,369	$ 4,570
Basic income (loss) per share of common stock:		
Continuing operations	$ 0.53	$ 0.55
Discontinued operations	(0.02)	(0.02)
	$ 0.51	$ 0.54
Diluted income (loss) per share of common stock:		
Continuing operations	$ 0.53	$ 0.55
Discontinued operations	(0.02)	(0.02)
	$ 0.51	$ 0.54
Cash dividends declared per share of common stock	$ 0.20	$ 0.20

Weighted average shares outstanding:		
Basic	8,522	8,521
Diluted	8,523	8,524

See notes to condensed consolidated financial statements.

Table of Contents

Lawson Products, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(Amounts in thousands)	For the Three Months Ended March 31, 2008	2007
Operating activities:		
Net income	$ 4,369	$ 4,570
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	2,142	1,920
Changes in operating assets and liabilities	(5,006)	(16,637)
Other	(2,234)	917
Net cash used for operating activities	(729)	(9,230)
Investing activities:		
Additions to property, plant and equipment	(1,206)	(3,528)
Net cash used for investing activities	(1,206)	(3,528)
Financing activities:		
Proceeds from revolving line of credit, net of payments	4,500	11,000
Dividends paid	(1,704)	(1,704)
Net cash provided by financing activities	2,796	9,296
Increase (decrease) in cash and cash equivalents	861	(3,462)
Cash and cash equivalents at beginning of period	2,473	4,320
Cash and cash equivalents at end of period	3,334	858
Cash held by discontinued operations	(785)	(639)
Cash and cash equivalents held by continuing operations at end of period	$ 2,549	$ 219

See notes to condensed consolidated financial statements.

Table of Contents

Lawson Products, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Dollars in Thousands)

Note A Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements 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 Lawson Products, Inc. s (the Company) Annual Report on Form 10-K for the year ended December 31, 2007. The Condensed Consolidated Balance Sheet as of March 31, 2008, the Condensed Consolidated Statements of Income and the Condensed Consolidated Statements of Cash Flows for the three-month periods ended March 31, 2008 and 2007 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-month period ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

FIN 48 We account for uncertain tax positions in accordance with FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which requires that the Company recognize in the financial statements the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. In addition, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. See Note I Income Tax Expense to the Condensed Consolidated Financial Statements for additional detail on our uncertain tax positions.

There have been no significant changes in our significant accounting policies during the three months ended March 31, 2008 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Note B Comprehensive Income

Comprehensive income was $4,178 and $4,629 for the first quarters of 2008 and 2007, respectively. Comprehensive income was negatively impacted by foreign currency translation adjustments of $191 in 2008 and positively impacted by foreign currency translation adjustments of $59 for the three-month period ended March 31, 2007.

Accumulated other comprehensive income consists only of foreign currency translation adjustments, net of related income tax.

Note C Earnings Per Share

The calculation of dilutive weighted average shares outstanding for the three months ended March 31, 2008 and 2007 are as follows (in thousands):

	Three months ended March 31	
	2008	2007
Basic weighted average shares outstanding	8,522	8,521
Dilutive impact of options outstanding	1	3
Dilutive weighted average shares outstanding	8,523	8,524

Table of Contents

Note D Revolving Line of Credit

The revolving line of credit has a maximum borrowing capacity of $75 million and a maturity date of March 27, 2009. The revolving line of credit carries a floating interest rate of prime minus 150 basis points or LIBOR plus 75 basis points, at the Company s option. At March 31, 2008, the effective rate was 3.75 percent. Interest is payable quarterly on prime rate borrowings and at contract expirations for LIBOR borrowings. The line of credit contains certain financial covenants regarding interest coverage, minimum stockholders equity and working capital, all of which the Company was in compliance with at March 31, 2008. The Company had $15.5 million of borrowings under the line of credit at March 31, 2008.

Note E Reserve for Severance

The table below shows the changes in the Company s reserves for severance and related payments, included in accrued expenses and other liabilities on the balance sheet as of March 31, 2008 and 2007:

	2008	2007
Balance at beginning of year	$ 7,058	$ 962
Charged to earnings	602	279
Cash paid	(1,315)	(604)
Adjustment to reserves	(42)	(120)
Balance at March 31	$ 6,303	$ 517

The charge to earnings in 2008 of $602 is related to severance costs associated with the departure of two executives. The charge to earnings in 2007 of $279 is related to severance costs arising from initiatives implemented in the first quarter of 2007 to improve domestic operational efficiencies. Severance costs in both years are related to the Maintenance, Repair and Operations distribution in North America (MRO) segment.

Table of Contents

Note F Intangible Assets

Intangible assets subject to amortization, included within other assets, were as follows (in thousands):

	March 31, 2008		
	Gross Balance	Accumulated Amortization	Net Carrying Amount
Trademarks and tradenames	$ 1,400	$ 750	$ 650
Non-compete covenant	1,000	450	550
	$ 2,400	$ 1,200	$ 1,200

	December 31, 2007		
	Gross Balance	Accumulated Amortization	Net Carrying Amount
Trademarks and tradenames	$ 1,400	$ 737	$ 663
Non-compete covenant	1,000	400	600
	$ 2,400	$ 1,137	$ 1,263

Trademarks and tradenames are being amortized over 15 years. The non-compete covenant associated with the 2005 acquisition of Rutland is being amortized over 5 years. Amortization expense, all of which is included in the MRO distribution segment, for these intangible assets is expected to be $250 per year for each of the next three years and $50 per year thereafter until the trademarks and tradenames are fully amortized.

Note G Stock-Based Compensation

The Stock Performance Plan (the Plan) provides for the issuance of incentive compensation to non-employee directors, officers and key employees in the form of stock performance rights (SPRs).

Stock Performance Rights

SPRs vest at 20 percent to 33 percent per year and 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. The Company estimates the fair value of SPRs using the Black-Scholes valuation model each quarter. This model requires the input of subjective assumptions that will usually have a significant impact on the fair value estimate. The weighted-average estimated fair value of SPRs outstanding at March 31, 2008 was $6.61 per SPR with the following assumptions:

	March 31, 2008
Expected volatility	38.77% to 48.65%
Risk-free interest rate	1.57% to 2.66%
Expected term (in years)	1.4 to 6.0
Expected dividend yield	2.90%

Table of Contents

In the first quarter of 2008 and 2007, a reduction to compensation expense for outstanding SPRs of $1.2 million and $0.7 million was recorded and included in selling, general and administrative expenses, respectively.

The following is a summary of the activity in the Company s SPRs during the quarter:

	Average SPR Exercise Price	# of SPRs
Outstanding December 31, 2007 (1)	$ 34.17	209,250
Granted	25.43	86,500
Exercised	27.08	(28,000)
Outstanding March 31, 2008 (2)	$ 32.09	267,750

(1) Includes 132,117 SPRs vested at December 31, 2007 at a weighted average exercise price of $31.26 per SPR.

(2) Includes 104,117 SPRs vested at March 31, 2008 at a weighted average exercise price of $32.38 per SPR.

The aggregate intrinsic value of SPRs outstanding as of March 31, 2008 is $(0.4) million.

As of March 31, 2008, there was $0.8 million of unrecognized compensation cost related to non-vested SPRs, which will be recognized over a weighted average period of 1.7 years.

Stock-based compensation expense recognized in the Condensed Consolidated Statements of Income for the first quarter of fiscal 2008 and 2007 has been reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

Table of Contents

Stock Options

The following is a summary of the activity in the Company s stock options during the quarter:

	Average Option Exercise Price	# of Options
Outstanding December 31, 2007	$ 23.11	5,000
Granted		
Exercised		
Forfeited/expired/cancelled		
Outstanding March 31, 2008	$ 23.11	5,000

Exercisable options at:	Weighted Average Price	Option Shares
December 31, 2007	$23.11	5,000
March 31, 2008	$23.11	5,000

As of March 31, 2008, the Company had the following outstanding options:

Exercise price	$ 23.56	$ 22.44
Options outstanding:	3,000	2,000
Weighted average exercise price	$ 23.56	$ 22.44
Weighted average remaining life (in years)	2.1	1.4
Options exercisable:	3,000	2,000
Weighted average exercise price	$ 23.56	$ 22.44

As of December 31, 2007, all outstanding stock options were fully vested, and no remaining unrecognized compensation expense is to be recorded in 2008.

Table of Contents

Note H Segment Reporting

The Company has two reportable segments: Maintenance, Repair and Operations distribution in North America (MRO), and Original Equipment Manufacturer distribution and manufacturing in North America (OEM). The Company s reportable segments are distinguished by the nature of products, types of customers, and manner of servicing customers.

The Company s MRO distribution segment supplies a wide range of MRO parts to repair and maintenance organizations primarily through the Company s force of independent field sales agents, as well as inside sales personnel.

The Company s OEM segment manufactures and distributes component parts to OEM manufacturers through a network of independent manufacturers representatives as well as internal sales personnel.

The Company evaluates performance and allocates resources to reportable segments primarily based on operating income.

The following table presents summary financial information for the Company s reportable segments:

	Three Months Ended March 31	
	2008	2007
Net sales		
MRO	$ 104,538	$ 106,286
OEM	20,466	23,383
Consolidated total	$ 125,004	$ 129,669
Operating income		
MRO	$ 7,494	$ 6,273
OEM	453	1,872
Consolidated total	$ 7,947	$ 8,145

The reconciliation of segment profit for continuing operations to consolidated income before income taxes consisted of the following:

	Three Months Ended March 31	
	2008	2007
Total operating income from reportable segments	$ 7,947	$ 8,145
Investment and other income	108	102
Interest expense	(229)	(81)
Income from continuing operations before income taxes	$ 7,826	$ 8,166

Asset information for continuing operations related to the Company s reportable segments consisted of the following:

	March 31, 2008	December 31, 2007
Total assets		
MRO	$ 216,447	$ 221,274
OEM	53,529	52,955
Total for reportable segments	269,976	274,229
Corporate	23,525	24,570
Consolidated total	$ 293,501	$ 298,799

At March 31, 2008 and December 31, 2007, the carrying value of goodwill within each reportable segment was as follows (in thousands):

MRO	$ 25,748
OEM	2,251
Consolidated total	$ 27,999

Note I Income Tax Expense

At December 31, 2007, the Company had $923 in unrecognized tax benefits, the recognition of which would have an effect of $923 on the effective tax rate. At March 31, 2008, the Company had $923 in unrecognized tax benefits, the recognition of which would have an effect of $923 on the effective tax rate.

Due to the uncertainty of both timing and resolution of income tax examinations, the Company is unable to determine whether any amounts included in the March 31, 2008 balance of unrecognized tax benefits represent tax positions that could significantly change during the next twelve months.

The Company s continuing practice is to recognize interest and penalties related to unrecognized tax benefits in income tax expense. The Company had $1,364 accrued for interest and penalties at both March 2008 and December 2007.

The Company and its subsidiaries are subject to U.S. federal income tax as well as income tax of multiple state and international jurisdictions. As of March 31, 2008, the Company is subject to U.S. federal income tax, non-U.S. income tax and state and local income tax examinations for the tax years 2000 through 2006.

Note J Legal Proceedings

In December 2005, the FBI executed a search warrant for records at the Company s offices and informed the Company that it was conducting an investigation as to whether any of the Company s representatives improperly provided gifts or awards to purchasing agents (including government purchasing agents) through the Company s customer loyalty programs. The U.S. Attorney s Office for the Northern District of Illinois subsequently issued a subpoena for documents in connection with this investigation. In April 2007, thirteen people, including seven former sales agents of the Company, were indicted on federal criminal charges, including mail fraud, in connection with the U.S. Attorney s investigation. These indictments allege that, under the Company s customer loyalty programs, sales agents would provide cash gift certificates to individuals purchasing Company merchandise on behalf of their employers as a way to increase their commissions and prices paid by customers. All of the cases involve commissioned sales agents of the Company. All seven of the indicted former sales agents have entered guilty pleas to federal criminal charges. Although the Company was not charged in connection with these indictments, the U.S. Attorney has announced that its investigation is continuing.

The Company s internal investigation regarding these matters has consisted of a review of the Company s records and interviews with Company employees and independent agents and is not complete. In conjunction with the Company s internal investigation, several customer loyalty programs were terminated because the Company believes that these programs provided or had the potential of providing promotional considerations, such as gifts and awards, to purchasing agents that the Company has deemed inappropriate. The Company has modified another customer loyalty program to limit the amount and nature of customer gifts distributed under the program. In addition, twenty-three independent agents have been terminated or have resigned and the Company has terminated four employees. The Company is cooperating with the ongoing investigation of the U.S. Attorney; however, the Company cannot predict when the investigation will be completed or what the outcome or the effect of the investigation will be. The outcome of the investigation could result in crim