

LAWSON PRODUCTS INC/NEW/DE/

Form 10-K

March 01, 2012

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-K**

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2011**

**or**

☐ **TRANSITION REPORT PURSUANT TO 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 Charter)

**Delaware**  
(State or other jurisdiction of

**36-2229304**  
(I.R.S. Employer

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incorporation or organization)

Identification No.)

1666 East Touhy Avenue, Des Plaines, Illinois 60018

(Address of principal executive offices)

Registrant's telephone number, including area code:

(847) 827-9666

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

Title of Each Class  
Common Stock, \$1.00 par value

Name of Each Exchange on Which Registered  
The NASDAQ Stock Market LLC

(NASDAQ Global Select Market)

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

None

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

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 ☐ 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 by Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the registrant's voting stock held by non-affiliates on June 30, 2011 (based upon the per share closing price of \$19.67) was approximately \$84,100,000.

As of January 31, 2012, 8,574,291 shares of Common Stock were outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

The following documents are incorporated into this Form 10-K by reference:

Part III incorporates information by reference to the registrant's definitive proxy statement, to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year.

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**Safe Harbor Statement under the Securities Litigation Reform Act of 1995:** This Annual Report on Form 10-K 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 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 risk factors set forth in Item 1A of this Form 10-K.

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.

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### **PART I**

#### **ITEM 1. BUSINESS.**

##### **Overview**

Lawson Products, Inc. ( Lawson , the Company , we , our , or us ) was incorporated in Illinois in 1952, and reincorporated in Delaware in 1997. Lawson is a North American distributor of products and services to the industrial, commercial, institutional, and governmental maintenance, repair and operations ( MRO ) marketplace and also manufactures and distributes production and specialized component parts to the original equipment manufacturers ( OEM ) marketplace.

##### Industry and Competition

The MRO industrial distribution industry consists of companies that buy and stock products in bulk and supply these products to customers on an as needed basis. The customer benefits from lower costs and convenience of ordering smaller quantities maintained by MRO suppliers. We estimate the MRO industrial distribution industry in North America to exceed \$100 billion in revenues.

There is a significant amount of fragmentation by geography and product within the industry. We encounter intense competition from several national distributors and manufacturers and a large number of regional and local distributors. Some competitors have greater financial and personnel resources, handle more extensive lines of merchandise, operate larger facilities and price some merchandise more competitively than we do.

We consider our large national competitors to be WW Grainger, Fastenal, McMaster Carr, MSC Industrial Direct, and Barnes Distribution. We compete for business in our industry by delivering on the value proposition we call Smarter Maintenance under which we offer a personal approach to vendor managed inventory, provide technical expertise and supply quality products to our customers.

##### Customers

Sales generated by our MRO segment represented over 95% of our total sales for the year ended December 31, 2011. Due to fewer selling days during the holiday season, net sales in the fourth quarter are historically lower than the first three quarters of the year. During 2011, we sold products to approximately 90,000 customers and no customer accounted for more than two percent of net sales. In 2011, 91% of our net sales were generated in the United States and 9% from Canada. Our customers operate in a variety of industries including automotive repair, commercial vehicle maintenance, government, manufacturing, food processing, distribution, construction, oil and gas, mining, wholesale, service and others.

Our customers include a wide range of purchasers of industrial supply products from small repair shops to large national and governmental accounts. Historically, we have been very effective at selling to and servicing small and medium sized customers. We are taking deliberate steps to gain a share of larger national accounts to expand our sales base. We have assembled a team of employee sales professionals to identify and prioritize strategic accounts, which we define as larger, multi-location national accounts. During 2011, strategic account sales grew by 18% over 2010 and represented approximately 10% of MRO net sales.

##### Operations

Customers place orders primarily through our independent sales representatives; however, they can also order directly from our website or through our customer service team via fax or phone. We sell products in all 50 states, the District of Columbia, Canada and Puerto Rico, and export products that support U.S. military efforts in Europe. An important factor in attracting and retaining customers is our ability to process orders promptly. We normally ship to our customers within one to two days of order placement.

Our MRO distribution process normally entails transporting product from our suppliers to our national packaging center for possible repackaging, labeling or cross-docking. Product is then shipped and stocked in strategically located distribution centers in Illinois, Nevada, New Jersey, Georgia, and Ontario where orders are picked, packed and shipped to our customers. Many factors affect the efficiency of this process including the physical characteristics of the distribution centers, routing logistics, the number of times the product needs to be handled, transportation costs and the flexibility to meet unique requirements requested by our customers.



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In 2011, we upgraded our business processes by completing a major phase of the implementation of a new Enterprise Resource Planning ( ERP ) system. The new ERP system integrates our revenue cycle, from initial order through cash receipt and the procurement cycle, from product sourcing through payment. ERP has replaced many of the diverse and aging legacy systems which have limited our operational capabilities in the past.

Our engineering department, as part of our Smarter Maintenance proposition, provides technical support for our products and offers on-site problem solutions. They also develop and present product safety and technical training seminars tailored to meet our customers needs. Material Safety Data Sheets are maintained electronically and are available to our customers 24 hours a day, seven days a week. Our labs provide us with the environment to solve technical problems remotely by simulating customer situations.

## Products

Our MRO product offerings are listed on our website and in approximately 27,000 catalogs that were distributed to our customers in 2011. Our MRO products are manufactured by others, purchased in bulk and repackaged in smaller quantities for sale to our customers.

Sales percentages by broad categories of our MRO product mix in 2011 were as follows:

| <b>Product Category</b>         | <b>September 30,<br/>Percentage</b> |
|---------------------------------|-------------------------------------|
| Fastening systems               | 21%                                 |
| Specialty chemicals             | 15                                  |
| Cutting tools and abrasives     | 14                                  |
| Fluid power                     | 13                                  |
| Electrical                      | 11                                  |
| Aftermarket automotive supplies | 5                                   |
| Welding and metal repair        | 4                                   |
| Safety                          | 3                                   |
| Other                           | 14                                  |
|                                 | 100%                                |

We offer over 300,000 different products for sale of which approximately 60,000 products are maintained in inventory. We strive to carry sufficient inventory to ensure product availability and rapid processing of customer orders. Accurate forecasting of customer demand is essential to establish the proper level of inventory for each product. Inventory levels need to be sufficient to meet customer demand while avoiding the costs of stocking excess items.

During 2011, we purchased products from over 1,000 suppliers and no single supplier accounted for more than five percent of our purchases in 2011. However, the loss of one of our core suppliers could affect our operations by hindering our ability to provide full service to our customers.

We actively participate in the design and development of products with our manufacturers. Technology has helped us to develop new items that are application specific. We review applications and recommend alternative products that may be beneficial to our customers. Our quality control department tests our product offerings to assure they meet our specifications. We also conduct failure analysis and recommend solutions to help customers maximize product performance and avoid costly product failures. To promote brand loyalty, we sell products using various private labels and tradenames including Lawson Products, Kent Automotive, Cronatron, and Drummond, among others.

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### **Sales Force**

Our sales force is primarily organized into geographical regions. The performance of each region is the responsibility of a Regional Sales Manager. Each region is further divided into geographically defined districts. The performance of each district is the responsibility of a District Sales Manager who reports to the Regional Sales Manager. Our District Sales Managers concentrate their efforts on driving sales within their district and working with our sales team, composed of approximately 950 independent sales representatives to develop new and existing customers.

Our independent representatives have control over which customers they contact, the frequency of sales calls, the products that are promoted, the prices that are charged and the sales methods that are used. The independent sales representatives are compensated on a variable commission only basis and are responsible for repayment of commissions to the Company on any uncollectible accounts. During the second half of 2011, we implemented a pilot program and hired approximately 40 employee sales representatives. We believe having control over which customers the employee sales representatives contact, the frequency of sales calls, the products that are promoted, the prices that are charged and the sales methods that are used could result in higher productivity. Employee sales representatives receive a fixed salary and are eligible for variable compensation related to sales.

We have also developed a team dedicated to acquiring larger strategic accounts and a team dedicated to serving our governmental accounts. The strategic accounts are comprised of multi-location customers with a national scope. We have assigned some employees to concentrate solely on mid-market account acquisition.

Our sales force receives education in the best uses of our products, enabling them to provide customized solutions to address our customers needs. As part of our Smarter Maintenance proposition, the sales team offers our customers technical expertise and on-site problem resolution. This includes on-site visits to help manage customer inventories, introducing cost saving ideas to improve our customers profitability and regularly analyzing and replenishing inventory to prevent unnecessary purchases and unplanned downtime. The sales force also periodically provides product demonstrations to our customers that are designed to show how our products can improve their productivity. Additionally, we offer customized storage systems to our customers for improved organization and a more efficient workflow.

### **Employees**

Our organization supports a culture of continuous improvement driving results and emphasizes the importance of addressing the needs of our customers. We encourage our employees to be results driven, team oriented, progressive and focused on the future. We require our employees to act with integrity in every aspect of our business.

As of December 31, 2011, our workforce included approximately 950 employees, comprised of approximately 360 in sales and marketing (including approximately 70 District Sales Managers), 440 in operations and distribution and 150 management and administrative staff. Approximately 15% of our workforce is covered by four collective bargaining agreements. We believe that our relations with our employees and their collective bargaining organizations are good.

### **Non-Core Businesses**

Over the past few years, our non-core MRO operations were hit particularly hard by the economic downturn, needed capital investment, had limited opportunity to leverage growth, provided minimal synergistic value and operated at lower margins than the core MRO business. Therefore, we actively evaluated various strategic alternatives regarding these operations.

In 2010, we sold substantially all of the assets of two of our non-core business units, Assembly Component Systems, Inc. and Rutland Tool & Supply Company, Inc. Currently our only non-core operating subsidiary is Automatic Screw Machine Products Company ( ASMP ). ASMP is based in Decatur, Alabama and distributes components, fasteners, and fittings for use by OEM customers that are specific to their production needs. ASMP accounted for approximately 5% of our net sales for 2011. We will continue to evaluate the strategic options available to us regarding ASMP.



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### **Vision**

Our vision is to be our customers' first choice for maintenance, repair and operational solutions that improve their operating performance. We plan to achieve our vision by working closely with our customers to maintain and enhance their operations through products, services and innovative solutions.

As part of developing a strategy to support our vision, we conducted extensive customer research to help better understand our customers' value drivers and the market in which we currently compete for business, known as our addressable market. We determined that we not only needed to transform our organization to win business from our current addressable market but also to develop the capabilities to expand the size of our addressable market. Therefore, we concentrated on three major initiatives to strengthen our business. Our initiatives were to replace our legacy information systems with a state-of-the-art ERP system, optimize our distribution network and transform our sales channels. Through these initiatives, we aim to deliver an enhanced customer experience, support sales growth and improve operating performance. We have made significant progress in completing each of these initiatives and have further defined the initiatives we will concentrate on to achieve our vision for the future. Our transformation efforts continue to focus on making it easier for our customers to conduct business with us.

### **ERP**

In August 2011, we reached an important milestone as we launched a major phase of our new ERP system. We believe that an integrated ERP system is necessary to support the transformation of our business to better serve our customers and to provide a platform to support growth. The initial implementation included order-to-cash and procure-to-pay processes, warehouse management at three of our distribution centers and our packaging facility as well as our financial reporting system. The ERP system is critical to provide the platform for the launch of our new website, to support the technology requirements of the new distribution center and enable the opportunity to provide enhanced sales solutions in the field. During 2012, we plan to implement the warehouse management system at our future McCook distribution center.

Although we were able to pick, pack and ship orders within hours of going live, we encountered certain challenges which caused delays in our supply chain and fulfillment processes. This led to an increase in backorders and complicated our inventory procurement process. We also experienced higher temporary labor and overtime costs as we worked to address the increase in the number of customer service calls and to reduce backorder levels in a timely manner. Additionally, we encountered certain operating issues that resulted in delays in the collection of our customer receivables. We have seen our backorders continue to decline as our fill rates improve.

We are continuing to resolve various operational issues and make further enhancements to the system as we become more experienced. We believe the new ERP system will provide us reliable, transparent, real-time data access enabling us to make better and faster business decisions leading to more accurate forecasting, shortening order fulfillment time and optimizing our inventory levels. Integration among various functional areas is already improving communication, productivity and efficiency. We believe these improvements will enhance our ability to respond to our customers' needs and lead to increased customer satisfaction.

### **Network Optimization**

The goal of our network optimization initiative is to define the optimal number, location, size, and material handling capabilities of our distribution centers to improve customer service, speed of delivery, lower operating expenses and improve working capital investment.

In November 2011, we entered into a lease for a new, state-of-the-art packaging and distribution center in McCook, Illinois. This new distribution facility will consolidate operations currently performed in three separate Illinois locations. The new facility is designed to specifically meet our distribution needs and will incorporate upgraded technology and logistics compared to our existing facilities. We expect this new distribution center will be operational by late 2012.

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The consolidation of operations in the new distribution facility is intended to reduce operating expenses being incurred under our current structure. Additional warehouse space provided by the new facility will allow us to support increased sales and together with the improved technology help reduce order processing times and increase order fulfillment rates. The facility's close proximity to a major freight hub will provide us more time to process orders and expand our next-day delivery capability.

In conjunction with closing the Des Plaines, Illinois facility, we will also relocate our corporate headquarters to a leased location in the City of Chicago, approximately three miles from our current headquarters in Des Plaines.

### **Sales Channel Transformation**

Our sales channel transformation initiative concentrates on the following areas:

#### *Sales Management Team Transformation*

We believe our sales team transformation can strengthen the quality of customer relationships and improve the consistency of sales execution throughout our organization.

Over the past two years, we have clarified the roles and responsibilities of our sales management team, continually reviewing our territory design and account allocation policies to optimize territory management while maintaining or increasing our customer coverage. We have established a strategic account team dedicated to execute on a market plan to acquire these large strategic accounts. We are also dedicating certain employees to concentrate solely on mid-market account acquisition. Additionally, we are hiring Business Development Managers to identify new business opportunities.

We plan to continue to review and evaluate our sales model to maximize sales and enhance customer satisfaction.

#### *Website Redevelopment*

We are committed to the re-development of a fully integrated website that will allow for new and existing customers to easily perform product searches, immediately obtain pricing and place direct orders through the internet. This will also allow the organization to help capture a portion of the unplanned purchases of our customers that often are placed through a website, an opportunity that we do not participate in today. The website will be designed to improve cross-selling and up-selling activity, as well as enhance our visibility to customers when our sales team is not on-site with the customer. We plan to introduce our new website in the second quarter of 2012.

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### *Pricing*

We are continuing to develop and implement a market-based, tiered pricing structure that better reflects the value of our products and services to our customers. This market-based approach should promote increasing penetration of our existing customers and attract new accounts at more competitive pricing levels. We are also refining our private label offerings with tiered pricing. The combination of private label and national brands products is designed to better position us to meet the needs of a larger, more diverse customer base and we believe provides a growth opportunity.

### *Next-Day Delivery*

Next-day delivery is an essential requirement identified by our customer research and historically we have lagged behind our competitors in this area. The implementation of ERP and our new state-of-the-art distribution facility in McCook, Illinois will enhance our next-day capabilities, allowing us to improve our qualification rate in bid processes and to compete for our customers' unplanned spend.

### *Product Offering*

We plan to expand our product portfolio to meet customer demand proactively and increase our ability to qualify and win business in competitive bid processes. The expanded product portfolio should help promote sales to new customers and increase our sales to existing customers. Historically, we have encouraged brand loyalty by selling products using various private labels. Although we will continue to promote private label products, we plan to add more national brands to our product offering to better align our product mix with customer specifications, particularly for larger accounts.

## **Available Information**

We file or furnish annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and file or furnish amendments to those reports pursuant to Section 13(a) or 15(d) of the Exchange Act and Section 16 reports with the Securities and Exchange Commission (SEC). The public can obtain copies of these materials by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington DC 20549 or by accessing the SEC's website at <http://www.sec.gov>. The public may obtain information on the operation of the SEC's Public Reference Room by calling (800) SEC-0330. In addition, as soon as reasonably practicable after such materials are filed with or furnished to the SEC, we make copies available to the public free of charge through our website at [www.lawsonproducts.com](http://www.lawsonproducts.com). Information on our website is not incorporated by reference into this report. We also make available, on our website, the charters of the committees of our Board of Directors, our Code of Business Conduct and our Corporate Governance Principles.

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The executive officers of Lawson as of January 31, 2012 were as follows.

|                     | September 30, | September 30,             | September 30,                                           |
|---------------------|---------------|---------------------------|---------------------------------------------------------|
|                     |               | Year First                |                                                         |
| Name                | Age           | Elected to Present Office | Position                                                |
| Thomas J. Neri      | 60            | 2007                      | President, Chief Executive Officer and Director         |
| Harry A. Dochelli   | 52            | 2009                      | Executive Vice President, Chief Operating Officer       |
| Neil E. Jenkins     | 62            | 2004                      | Executive Vice President, Secretary and General Counsel |
| Robert O. Border    | 48            | 2010                      | Senior Vice President, Chief Information Officer        |
| Stewart A. Howley   | 50            | 2008                      | Senior Vice President, Strategic Business Development   |
| Ronald J. Knutson   | 48            | 2009                      | Senior Vice President, Chief Financial Officer          |
| Michelle I. Russell | 50            | 2012                      | Senior Vice President, Project Management               |

Biographical information for the past five years relating to each of our executive officers is set forth below.

**Mr. Neri** was elected Chief Executive Officer in April 2007 and was elected to the Board of Directors in December 2007. Mr. Neri was elected President and Chief Operating Officer in January 2007 and was elected Executive Vice President, Finance, Planning and Corporate Development; Chief Financial Officer and Treasurer in 2004.

**Mr. Dochelli** was elected Chief Operating Officer effective December 2009 and served as Executive Vice President, Sales and Marketing from April 2008 to December 2009. Previously, Mr. Dochelli served as Executive Vice President, North America Contract Sales for OfficeMax from 2007 until 2008 and Executive Vice President of U.S. Operations for OfficeMax/Boise Cascade Office Solutions from 2005 to 2007.

**Mr. Jenkins** was elected Executive Vice President, Secretary and General Counsel in 2004.

**Mr. Border** was elected Senior Vice President, Chief Information Officer in December 2010 and served as Senior Vice President, Information Technology from September 2009 to December 2010. Previously, Mr. Border served as the Managing Director, Information Technology at Midwest Generation, a subsidiary of Edison Mission Energy, from 2004 until 2009.

**Mr. Howley** was elected Senior Vice President, Strategic Business Development effective April 2008. Mr. Howley served as Chief Marketing Officer from December 2005 until May 2008.

**Mr. Knutson** was elected Senior Vice President, Chief Financial Officer effective November 2009. Mr. Knutson served as Senior Vice President, Chief Financial Officer of Frozen Food Express Industries, Inc. from January 2009 to November 2009. Mr. Knutson served as Vice President, Finance of Ace Hardware Corporation from 2006 through 2007.

**Ms. Russell** was appointed Senior Vice President, Project Management in January 2012. Ms. Russell served as Senior Vice President, Executive Sponsor from March 2010 to January 2012; as Senior Vice President, Operations and Supply Chain Management from August 2007 to March 2010; and as Chief Ethics and Compliance Officer from April 2006 to August 2007.

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### **ITEM 1A. RISK FACTORS.**

In addition to the other information in this Annual Report on Form 10-K for the fiscal year ended December 31, 2011, the following factors should be considered in evaluating Lawson's business. Our operating results depend upon many factors and are subject to various risks and uncertainties. The material risks and uncertainties known to us and described below may negatively affect our business operations or affect our financial results. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations or affect our financial results.

#### ***Our results of operations may be adversely impacted by a downturn in the economy.***

During 2008 and 2009, we experienced the effects of a severe economic recession in the U.S. and world economies and a tightening of the credit markets. Although the economy has stabilized and improved somewhat in 2010 and 2011, we cannot predict the continued strength of a recovery. Any future economic decline and uncertainty may lead to a further decrease in customer spending and may cause certain customers to cancel or delay placing orders. Some of our customers may file for bankruptcy protection, preventing us from collecting on accounts receivable and may result in our stocking excess customer specific inventory. Continued contraction in the credit markets may also cause some of our customers to experience difficulties in obtaining financing, leading to lower sales, delays in the collection of receivables or result in an increase in bad debt expense.

Adverse economic conditions could also affect our key suppliers, hindering their ability to supply parts and result in delays of our customer shipments. Economic uncertainty can make it difficult for us to accurately predict future order activity and affect our ability to effectively manage inventory levels and identify risks that may affect our business. Our ability to finance our operations by borrowing through our current credit agreement could also be at risk if the lender is unable to provide funds under the terms of the agreement due to a bankruptcy or a restructuring. There are no assurances that we would be able to establish alternative financing or attain financing with terms similar to our present credit agreement.

#### ***The market price of our common stock may decline.***

Our stock price could decrease if our financial performance is inadequate or does not meet investors' expectations, if there is deterioration in the overall market for equities, large amounts of shares are sold in the market or if investors have concerns that our business, financial condition, results of operations and capital requirements are negatively impacted by an economic downturn. A decrease in the price of our stock may reflect a lower market value of our net assets compared to book value, indicating our assets are impaired.

#### ***A significant portion of our inventory may become obsolete.***

Our business strategy requires us to carry a significant amount of inventory in order to meet rapid processing of customer orders. If our inventory forecasting and production planning processes result in inventory levels exceeding the levels demanded by customers or should our customers decrease their orders with us, our operating results could be adversely affected due to costs of carrying the inventory and additional inventory write-downs for excess and obsolete inventory.

#### ***Work stoppages and other disruptions at transportation centers or shipping ports may adversely affect our ability to obtain inventory and make deliveries to our customers.***

Our ability to rapidly process customer orders is an integral component of our overall business strategy. Interruptions at our company operated facilities or disruptions at a major transportation center or shipping port, due to events such as severe weather, labor interruptions, natural disasters, acts of terrorism or other events, could affect both our ability to maintain core products in inventory and deliver products to our customers on a timely basis, which may in turn adversely affect our results of operations. We will also face a risk of service disruptions during the transition of our Addison, Des Plaines and Vernon Hills, Illinois operations into the new McCook facility. In addition, severe weather conditions could adversely affect demand for our products.

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### ***Changes in our customers, product mix and pricing strategy could cause our gross margin percentage to decline in the future.***

From time to time, we have experienced changes in product mix and inventory costs. When our product mix changes, there can be no assurance that we will be able to maintain our historical gross profit margins. Changes in our customers, product mix, volume of orders or the prices charged could cause our gross profit margin percentage to decline.

### ***Increases in energy costs and the cost of raw materials used in our products could impact our cost of goods and distribution and occupancy expenses, which may result in lower operating margins.***

Increases in the cost of raw materials used in our products (e.g., steel) and energy costs raise the production costs of our vendors. Those vendors typically look to pass the higher costs along to us through price increases. If we are unable to fully pass these increased prices and costs through to our customers or to modify our activities, the impact would have an adverse effect on our operating profit margins.

### ***Disruptions of our information and communication systems could adversely affect the Company.***

We depend on our information and communication systems to process orders, purchase and manage inventory, maintain cost-effective operations, sell and ship products, manage accounts receivable collections and service our customers. Disruptions in the operation of information and communication systems can occur due to a variety of factors including power outages, hardware failure, programming faults and human error. Any disruption in the operation of our information and communication systems whether over a short or an extended period of time or affecting one or multiple distribution centers could have a material adverse effect on our business, financial condition and results of operations.

### ***The inability of management to successfully implement major strategic initiatives, could result in significant disruptions in the Company's operations and increase our costs.***

We have committed to developing and executing three major strategic initiatives to strengthen our core MRO operations which we believe will significantly enhance our ability to better serve our customers and improve our business. The initiatives are expected to transform our current sales channels, optimize our supply network and replace our legacy information systems with an ERP system. In 2011 we completed a major phase of the ERP implementation and we took further steps to transform our sales channels. In 2012, among other undertakings, we plan to continue to implement further phases of our ERP system, transition our Addison, Des Plaines and Vernon Hills, Illinois operations to the new McCook facility, launch a redesigned website and migrate our independent sales representatives to employee sales representatives.

These initiatives involve a large investment of capital and resources and significant changes to our current operating processes. Failure to properly implement one or more of these initiatives could result in disruptions in our operations, loss of business and increased costs.

### ***Failure to manage changes within the organization***

We are undergoing significant change including the opening of a new distribution center, relocation of our headquarters, completion of the ERP implementation, launch of a redesigned website and the transition of our independent sales representative model to one that increases productivity and is more market oriented. During the second half of 2011, we implemented a pilot program and hired approximately 40 employee sales representatives. We believe having control over which customers the employee sales representatives contact, the frequency of sales calls, the products that are promoted, the prices that are charged and the sales methods that are used could result in higher productivity. These initiatives, and other changes, could impact our business model and affect the culture of our organization to emphasize continuous improvements, be results driven and focused on our end customer. Failure to manage through these changes could adversely affect our financial position and results of operations.

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### ***Failure to retain talented employees, managers and executives could negatively impact our operating results.***

Our success depends on our ability to attract, develop and retain talented employees, including executives and other key managers. The loss of certain key executives and managers, or the failure to attract and develop talented new executives and managers, could have a material adverse effect on our business.

### ***Failure to retain experienced and productive sales representatives could negatively impact our operating results.***

Our MRO sales are primarily driven by sales representatives. Failure to attract and retain a sufficient number of talented, experienced and productive sales representatives could have a material adverse effect on our business, financial condition and results of operations.

### ***One stockholder controls the voting rights of approximately 45% of the Company's outstanding shares.***

At December 31, 2011, members of the Port family collectively beneficially owned approximately 45% of the outstanding shares of our common stock. In March 2011, in connection with the settlement of litigation between certain members of the Port family, Dr. Port received a proxy to vote the shares held by the members of the Port family until June 2012, other than in connection with votes on mergers and certain other extraordinary corporate transactions. As a result, Dr. Port has sole voting power of approximately 45% of the Company's outstanding shares, which effectively permits him to control stockholder votes concerning the removal and election of directors. The interests of Dr. Port may differ from those of other stockholders.

In addition, in filings with the Securities and Exchange Commission a member of the Port family, controlling approximately a third of the family's interest, has indicated that she intends to sell her shares. Given the low historic trading volume of our common stock, such sales could reduce the market price of our common stock.

### ***The Company operates in highly competitive markets.***

Our marketplace, although consolidating, still includes large, fragmented industries which are highly competitive. We believe that customers and competitors may continue to consolidate over the next few years, which may make the industry even more competitive. Our competitors include companies with similar or greater market presence, name recognition, and financial, marketing, and other resources and we believe they will continue to challenge the marketplace with their product selection, financial resources, and services.

### ***Future acquisitions are subject to integration and other risks.***

We anticipate that we may, from time to time, selectively acquire additional businesses or assets. Acquisitions are accompanied by risks, such as potential exposure to unknown liabilities of acquired companies and the possible loss of key employees and customers of the acquired business. In addition, we may not obtain the expected benefits or cost savings from acquisitions. Acquisitions are subject to risks associated with financing the acquisition and integrating the operations and personnel of the acquired businesses or assets. If any of these risks materialize, they may result in disruptions to our business and the diversion of management time and attention, which could increase the costs of operating our existing or acquired businesses or negate the expected benefits of the acquisitions.

### ***Failure to meet the covenant requirements of our credit agreement could lead to higher financing costs, increased restrictions and reduce or eliminate our ability to borrow funds.***

From time to time we fund our operations from funds borrowed under the terms of our credit agreement. The credit agreement requires us to comply with certain financial covenants, including minimum tangible net worth levels, a minimum cash, accounts receivable and inventory-to-debt ratio, a minimum debt service coverage ratio and minimum quarterly EBITDA levels. The credit agreement also contains other customary representations, warranties, covenants and events of default. Any failure to meet these covenant requirements could lead to higher financing costs, increased restrictions and reduce or eliminate our ability to borrow funds.

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*Changes that affect governmental and other tax-supported entities could negatively impact our sales and earnings.*

A portion of our sales are derived from the United States military and other governmental and tax supported entities. These entities are largely dependent upon government budgets and require adherence to certain laws and regulations. A decrease in the levels of defense and other governmental spending or the introduction of more stringent governmental regulations and oversight could lead to reduced sales or an increase in compliance costs which would adversely affect our financial position and results of operations.

*Any violation of Federal, state or local environmental protection regulations could lead to significant penalties and fines.*

Our product offering includes a wide variety of industrial chemicals and other products which are subject to a multitude of Federal, state and local regulations. These environmental protection laws change frequently and affect the composition, handling, transportation, storage and disposal of the products. Failure to comply with these regulations could lead to severe penalties and fines for each violation.

*Our results of operations could be affected by changes in taxation.*

Our results of operations could be affected by changes in tax rates, audits by taxing authorities or changes in laws, regulations and their interpretation. Changes in applicable tax laws and regulations could also affect our ability to realize the deferred tax assets on our balance sheet, which could affect our results of operations.

*We are currently the subject of an employment tax examination which could result in a negative settlement.*

One of our subsidiaries, Drummond American LLC ( Drummond ) is under an employment tax examination for the years 2007 and 2008 of the long-standing treatment of its sales representatives as independent contractors. In January 2012 we received a Notice of Proposed Adjustment in the amount of \$9.5 million, including penalties, from the IRS challenging Drummond's position that the sales representatives were independent contractors. Although we intend to vigorously defend our position for the treatment of the sales representatives as independent contractors, we established a liability of \$1.2 million as our best estimate of the cost to resolve the matter. An unfavorable outcome of this matter could have a material adverse effect on the Company's business, financial condition and results of operation.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.



**Table of Contents****ITEM 2. PROPERTIES.**

In the second half of 2012, we will be consolidating our Midwest distribution operations to a new custom built distribution facility in McCook, Illinois. We also plan to relocate our corporate headquarters to Chicago, Illinois from the current facility in Des Plaines, Illinois. When these relocations have been completed, we will reclassify our Addison, Des Plaines and Vernon Hills, Illinois facilities as Property Held for Sale.

The following owned and leased locations are either currently used in operations or will be used in our operations in 2012:

| Location                        | September 30,<br>Segment | September 30,<br>Function | September 30,<br>Own/Lease | September 30,<br>Square<br>Footage |
|---------------------------------|--------------------------|---------------------------|----------------------------|------------------------------------|
| <u>Locations to be used</u>     |                          |                           |                            |                                    |
| Chicago, Illinois               | MRO                      | Administration            | Lease(1)                   | 86,300                             |
| Fairfield, New Jersey           | MRO                      | Distribution              | Own                        | 60,000                             |
| Independence, Ohio              | MRO                      | Call Center               | Lease(2)                   | 9,761                              |
| McCook, Illinois                | MRO                      | Packaging/Distribution    | Lease(3)                   | 306,805                            |
| Mississauga, Ontario Canada     | MRO                      | Distribution              | Own                        | 78,000                             |
| Reno, Nevada                    | MRO                      | Distribution              | Own                        | 244,280                            |
| Suwanee, Georgia                | MRO                      | Distribution              | Own                        | 91,235                             |
| Decatur, Alabama                | OEM                      | Manufacturing             | Own                        | 65,000                             |
| <u>Locations to be disposed</u> |                          |                           |                            |                                    |
| Addison, Illinois               | MRO                      | Distribution              | Own                        | 85,800                             |
| Des Plaines, Illinois           | MRO                      | Packaging/Administration  | Own                        | 175,000                            |
| Des Plaines, Illinois           | MRO                      | Administration            | Own                        | 45,000                             |
| Des Plaines, Illinois           | MRO                      | Administration            | Lease(4)                   | 114,000                            |
| Vernon Hills, Illinois          | MRO                      | Distribution              | Own                        | 107,061                            |

(1) Lease expires in March 2023 with future minimum lease payments of \$12.2 million.

(2) Lease expires in April 2014 with future minimum lease payments of \$0.5 million.

(3) Lease expires in June 2022 with future minimum lease payments of \$14.8 million.

(4) Lease expires in March 2012

While we believe that our facilities to be used will be adequate to meet our needs, we will continue to assess the location and operation of our facilities to determine whether they meet the strategic needs of our business.

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### **ITEM 3. LEGAL PROCEEDINGS.**

The Company is involved in legal actions that arise in the ordinary course of business. It is the opinion of management that the resolution of any currently pending litigation will not have a material adverse effect on the Company's financial position or results of operations.

One of the Company's subsidiaries, Drummond American LLC ( "Drummond" ) is under an employment tax examination for the years 2007 and 2008 of the long-standing treatment of its sales representatives as independent contractors. In January 2012 the Company received a Notice of Proposed Adjustment in the amount of \$9.5 million, including penalties, from the IRS challenging Drummond's position that the sales representatives were independent contractors. Although the Company intends to vigorously defend its position for the treatment of its sales representatives as independent contractors, the Company established a liability of \$1.2 million as its best estimate of the cost to resolve this matter. An unfavorable outcome of this matter could have a material adverse effect on the Company's business, financial condition and results of operation.

In August 2008, the Company entered into a Deferred Prosecution Agreement ( "DPA" ) with the U.S. Attorney's Office in connection with representatives of the Company improperly providing gifts or awards to purchasing agents through the Company's customer loyalty programs. Pursuant to the DPA, the Company agreed to a \$30.0 million penalty and paid \$10.0 million in 2010, 2009 and 2008. The DPA expired in 2011.

The Company has identified that it has shipped a limited number of products in violation of certain state environmental regulations. The Company reported its findings to appropriate regulatory agencies and also recalled a limited number of products and is working with state regulators to take appropriate remedial actions to comply with these environmental regulations. At December 31, 2011, the Company has accrued \$0.2 million for penalties and expenses related to environmental matters and at this time, the Company cannot determine if any further expenses may be incurred.

### **ITEM 4. MINE SAFETY DISCLOSURES.**

Not applicable

**Table of Contents****PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

The Company's Common Stock is traded on the NASDAQ Global Select Market under the symbol of LAWS. The following table sets forth the high and low sale prices as reported on the NASDAQ Global Select Market along with cash dividends declared for each outstanding share during the last two years for the periods presented.

|                | September 30, |       | September 30,<br>2011 |       | September 30,                              |      | September 30, |       | September 30,<br>2010 |       | September 30,                              |      |
|----------------|---------------|-------|-----------------------|-------|--------------------------------------------|------|---------------|-------|-----------------------|-------|--------------------------------------------|------|
|                |               |       |                       |       | Cash<br>Dividends<br>Declared per<br>Share |      |               |       |                       |       | Cash<br>Dividends<br>Declared per<br>Share |      |
|                | High          | Low   | High                  | Low   | High                                       | Low  | High          | Low   | High                  | Low   | High                                       | Low  |
| First Quarter  | \$            | 27.21 | \$                    | 18.61 | \$                                         | 0.12 | \$            | 18.40 | \$                    | 15.10 | \$                                         | 0.06 |
| Second Quarter |               | 25.25 |                       | 17.85 |                                            | 0.12 |               | 18.88 |                       | 12.64 |                                            | 0.06 |
| Third Quarter  |               | 21.27 |                       | 13.26 |                                            | 0.12 |               | 18.60 |                       | 13.41 |                                            | 0.08 |
| Fourth Quarter |               | 17.79 |                       | 13.38 |                                            | 0.12 |               | 27.11 |                       | 14.19 |                                            | 0.12 |

**Table of Contents****ITEM 6. SELECTED FINANCIAL DATA.**

The following selected financial data should be read in conjunction with the Consolidated Financial Statements of the Company and Notes thereto included elsewhere in this Annual Report. The income statement data and balance sheet data are for, and as of the end of each of, the years in the five-year period ended December 31, 2011, and are derived from the audited Consolidated Financial Statements of the Company. The results of discontinued operations have been reclassified from continuing operations for all periods presented.

|                                                         | September 30,<br>2011 <sup>(1)</sup> | September 30,<br>2010 <sup>(2)</sup> | September 30,<br>2009 | September 30,<br>2008 <sup>(3)</sup> | September 30,<br>2007 |
|---------------------------------------------------------|--------------------------------------|--------------------------------------|-----------------------|--------------------------------------|-----------------------|
| <b>(Dollars in thousands, except per share data)</b>    |                                      |                                      |                       |                                      |                       |
| Net sales                                               | \$ 314,959                           | \$ 316,780                           | \$ 301,769            | \$ 376,572                           | \$ 390,307            |
| Income (loss) from continuing operations <sup>(4)</sup> | \$ (4,389)                           | \$ 9,590                             | \$ 1,912              | \$ (23,679)                          | \$ 8,262              |
| Income (loss) from discontinued operations              | (235)                                | (2,653)                              | (4,648)               | (3,952)                              | 2,367                 |
| Net income (loss)                                       | \$ (4,624)                           | \$ 6,937                             | \$ (2,736)            | \$ (27,631)                          | \$ 10,629             |
| Basic income (loss) per share of common stock:          |                                      |                                      |                       |                                      |                       |
| Continuing operations                                   | \$ (0.51)                            | \$ 1.13                              | \$ 0.22               | \$ (2.78)                            | \$ 0.97               |
| Discontinued operations                                 | (0.03)                               | (0.32)                               | (0.54)                | (0.46)                               | 0.28                  |
| Net income (loss)                                       | \$ (0.54)                            | \$ 0.81                              | \$ (0.32)             | \$ (3.24)                            | \$ 1.25               |
| Diluted income (loss) per share of common stock:        |                                      |                                      |                       |                                      |                       |
| Continuing operations                                   | \$ (0.51)                            | \$ 1.12                              | \$ 0.22               | \$ (2.78)                            | \$ 0.97               |
| Discontinued operations                                 | (0.03)                               | (0.31)                               | (0.54)                | (0.46)                               | 0.28                  |
| Net income (loss)                                       | \$ (0.54)                            | \$ 0.81                              | \$ (0.32)             | \$ (3.24)                            | \$ 1.25               |
| Cash dividends declared per share                       | \$ 0.48                              | \$ 0.32                              | \$ 0.18               | \$ 0.80                              | \$ 0.80               |
| Total assets                                            | \$ 222,748                           | \$ 236,384                           | \$ 241,647            | \$ 271,223                           | \$ 299,863            |
| Noncurrent liabilities                                  | \$ 36,697                            | \$ 37,968                            | \$ 41,761             | \$ 64,139                            | \$ 52,660             |
| Stockholders' equity                                    | \$ 134,172                           | \$ 142,865                           | \$ 136,646            | \$ 138,744                           | \$ 174,361            |

**Notes:**

- (1) The 2011 results from continuing operations include an impairment charge of \$1.1 million relating to certain long-lived assets and a \$1.2 million provision for the estimated cost of settling an IRS employment tax matter.

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- (2) The 2010 results from continuing operations include a \$4.1 million benefit from legal settlements and a \$1.7 million gain on sale of assets.
- (3) The 2008 results from continuing operations include a \$4.0 million charge related to unclaimed property liabilities.
- (4) Settlement and related charges of \$0.2 million, \$31.7 million and \$5.8 million related to the investigation and Deferred Prosecution Agreement were recorded in 2009, 2008 and 2007, respectively.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. OVERVIEW**

2011 was a transformational year for Lawson as we made substantial progress on strategic initiatives we have identified as critical to our long-term success. These initiatives included replacing our outdated legacy systems with a state-of-the-art ERP system, optimizing our distribution network and transforming our sales organization to allow our customers to conduct business with us through multiple channels.

In August 2011, after extensive preparation, we went live with our new ERP system. Within hours of the system going live, we were able to pick, pack, and ship orders. However, certain configuration issues caused delays in our supply chain and fulfillment processes leading to an increase in backorders and complicated our inventory procurement process. Consequently, we experienced a decline in net sales in the second half of 2011. We also experienced higher temporary labor, overtime and freight costs as we worked to reduce backorders in a timely manner. We are making progress resolving many of these issues as we begin to take advantage of the system's capabilities.

The new ERP system is designed to provide us with the ability to access reliable, transparent, real-time data, allowing us to meet the technology requirements of state-of-the-art distribution and packaging centers. In November 2011, we entered into a lease for a new, state-of-the-art packaging and distribution center in McCook, Illinois. This new facility will consolidate operations currently performed in our Illinois locations. The new facility is designed to specifically meet our distribution needs and will incorporate upgraded technology and increased space. We anticipate the combined operations will streamline our distribution logistics and reduce our cost structure. The facility's close proximity to a major freight hub will provide us more time to process orders and expand our next-day delivery capabilities. In conjunction with closing the Des Plaines facility, we plan to relocate our corporate headquarters to a location approximately three miles from our current location. We anticipate these moves will be completed in the second half of 2012.

Our new ERP system is also allowing us to make progress on our sales channel transformation initiatives. We have been investing in the design and development of a new eCommerce website, which we expect to introduce to our customers in the first half of 2012. With the launch of our new website, our customers will have access to an integrated sales channel, allowing them to research products and prices and to place orders on a 24/7 basis. This improvement should help us capture a portion of our customers' unplanned purchases.

Also, during 2011, we amended our existing \$55.0 million dollar credit facility, extending the term until October, 2016 and improving pricing. We also amended financial covenants, giving us the flexibility to better implement our strategic initiatives and further invest in our business. During 2011, we continued to distribute a quarterly cash dividend of \$0.12 per share, representing a dividend yield of 3.1% based on our December 31, 2011 stock price. We ended the year with \$2.1 million of cash and no outstanding borrowings. We believe our existing cash-on-hand and our untapped credit facility provide us with the capital resources to make the necessary investments to continue the transformation of our business and allow us to pursue future growth opportunities.

**Table of Contents****SUMMARY OF FINANCIAL PERFORMANCE**

|                                                                    | September 30,<br>2011 | September 30,<br>2011 | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2010 | September 30,<br>2010 | September 30,<br>2009 | September 30,<br>2009 |
|--------------------------------------------------------------------|-----------------------|-----------------------|----------------------------------------------------------------------------|-----------------------|-----------------------|-----------------------|
|                                                                    | Amount                | % of<br>Net<br>Sales  | Amount                                                                     | % of<br>Net<br>Sales  | Amount                | % of<br>Net<br>Sales  |
| Net sales                                                          |                       |                       |                                                                            |                       |                       |                       |
| MRO                                                                | \$ 300,399            | 95.4%                 | \$ 303,138                                                                 | 95.7%                 | \$ 289,715            | 96.0%                 |
| OEM                                                                | 14,560                | 4.6                   | 13,642                                                                     | 4.3                   | 12,054                | 4.0                   |
| Consolidated total                                                 | \$ 314,959            | 100.0%                | \$ 316,780                                                                 | 100.0%                | \$ 301,769            | 100.0%                |
| Gross profit                                                       |                       |                       |                                                                            |                       |                       |                       |
| MRO                                                                | \$ 176,872            | 58.9%                 | \$ 192,544                                                                 | 63.5%                 | \$ 184,430            | 63.7%                 |
| OEM                                                                | 2,905                 | 20.0                  | 2,282                                                                      | 16.7                  | 1,129                 | 9.4                   |
| Consolidated total                                                 | 179,777               | 57.1                  | 194,826                                                                    | 61.5                  | 185,559               | 61.5                  |
| Operating expenses (benefits):                                     |                       |                       |                                                                            |                       |                       |                       |
| Selling, general and administrative expenses                       | 181,291               | 57.6                  | 180,021                                                                    | 56.8                  | 177,421               | 58.8                  |
| Severance expenses                                                 | 1,614                 | 0.5                   | 3,629                                                                      | 1.2                   | 6,228                 | 2.1                   |
| Loss (gain) on sale of assets                                      | 22                    |                       | (1,701)                                                                    | (0.5)                 | 16                    |                       |
| Other operating expenses (income)                                  | 2,346                 | 0.7                   | (4,050)                                                                    | (1.3)                 | 481                   | 0.1                   |
| Total operating expenses                                           | 185,273               | 58.8                  | 177,899                                                                    | 56.2                  | 184,146               | 61.0                  |
| Operating income (loss)                                            | (5,496)               | (1.7)                 | 16,927                                                                     | 5.3                   | 1,413                 | 0.5                   |
| Interest expense                                                   | (681)                 | (0.2)                 | (391)                                                                      | (0.1)                 | (1,037)               | (0.3)                 |
| Other income, net                                                  | 101                   |                       | 160                                                                        | 0.1                   | 1,029                 | 0.3                   |
| Income (loss) from continuing operations before income tax expense | (6,076)               | (1.9)                 | 16,696                                                                     | 5.3                   | 1,405                 | 0.5                   |
| Income tax (benefit) expense                                       | (1,687)               | (0.5)                 | 7,106                                                                      | 2.3                   | (507)                 | (0.1)                 |
| Income (loss) from continuing operations                           | \$ (4,389)            | (1.4)%                | \$ 9,590                                                                   | 3.0%                  | \$ 1,912              | 0.6%                  |

**Table of Contents****RESULTS OF OPERATIONS FOR 2011 AS COMPARED TO 2010***Net Sales and Gross Profit*

Sales and gross profit results for the years ended December 31, 2011 and 2010 were as follows:

|                     | September 30,<br>Year ended December 31,<br>2011 | September 30,<br>(Dollars in thousands)<br>December 31,<br>2010 | September 30,<br>Amount | September 30,<br>Change<br>% |
|---------------------|--------------------------------------------------|-----------------------------------------------------------------|-------------------------|------------------------------|
| <b>Net sales</b>    |                                                  |                                                                 |                         |                              |
| MRO                 | \$ 300,399                                       | \$ 303,138                                                      | \$ (2,739)              | (0.9)%                       |
| OEM                 | 14,560                                           | 13,642                                                          | 918                     | 6.7                          |
| Consolidated        | \$ 314,959                                       | \$ 316,780                                                      | \$ (1,821)              | (0.6)                        |
| <b>Gross profit</b> |                                                  |                                                                 |                         |                              |
| MRO                 | \$ 176,872                                       | \$ 192,544                                                      | \$ (15,672)             | (8.1)%                       |
| OEM                 | 2,905                                            | 2,282                                                           | 623                     | 27.3                         |
| Consolidated        | \$ 179,777                                       | \$ 194,826                                                      | \$ (15,049)             | (7.7)                        |

|                            |       |       |
|----------------------------|-------|-------|
| <b>Gross profit margin</b> |       |       |
| MRO                        | 58.9% | 63.5% |
| OEM                        | 20.0  | 16.7  |
| Consolidated               | 57.1  | 61.5  |

Net sales for 2011 decreased 0.6% to \$315.0 million from \$316.8 million in 2010 on one less selling day. Excluding the Canadian exchange rate impact, net sales decreased 1.0% for the year. MRO net sales decreased \$2.7 million or 0.9% in 2011 to \$300.4 million from \$303.1 million in 2010. The decrease was largely due to certain challenges we encountered following the launch of our ERP system which caused delays in our supply chain and fulfillment processes leading to a build-up of backorders and lost sales in the second half of the year. For the year, average MRO daily sales were \$1.197 million in 2011 compared to \$1.203 million in 2010. In the first half of 2011, prior to the ERP launch our average MRO daily sales were \$1.259 million, up 7.5% over 2010 levels. Immediately after the launch in August, we saw average MRO daily sales drop as we encountered the issues described above. As we have worked to resolve these challenges, average daily sales have begun to recover as shown in the table below. (All amounts for 2011):

|                | September 30,<br>Net MRO<br>Sales | September 30,<br>Average MRO Daily Sales<br>Amount | September 30,<br>Sequential<br>quarterly<br>percentage<br>increase/<br>(decrease) |
|----------------|-----------------------------------|----------------------------------------------------|-----------------------------------------------------------------------------------|
| First quarter  | \$ 79,255                         | \$ 1,258                                           | 4.6%                                                                              |
| Second quarter | 80,625                            | 1,260                                              | 0.2                                                                               |
| Third quarter  | 71,490                            | 1,117                                              | (11.3)                                                                            |
| Fourth quarter | 69,029                            | 1,150                                              | 3.0                                                                               |
| Total Year     | \$ 300,399                        | 1,197                                              |                                                                                   |



OEM net sales increased \$0.9 million or 6.7% in 2011 to \$14.6 million from \$13.6 million in 2010.

Overall gross profit decreased 7.7% in 2011 to \$179.8 million from \$194.8 million in 2010. As a percent of sales, gross profit margin decreased to 57.1% in 2011 compared to 61.5% in 2010. MRO gross profit decreased 8.1% in 2011 to \$176.9 million from \$192.5 million in 2010. As a percent of net sales, MRO gross profit margin decreased to 58.9% in 2011 from 63.5% in 2010. This decline was driven by four main factors: (1) increased vendor costs were not passed along to our customers as we held pricing constant to facilitate our ERP implementation; (2) outbound freight

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costs increased as we shipped more single line orders to support our customers following the ERP conversion; (3) increased labor costs associated with the packaging of inventory; and (4) a strategic decision to pursue larger customers with lower margins, which is expected to increase retention and allow for dollar margin expansion over time. We also encountered a deterioration of MRO gross margins subsequent to our ERP conversion. MRO gross margins for the first, second, third and fourth quarters of 2011 were 62.2%, 59.1%, 58.4% and 55.3 %, respectively.

OEM gross profit increased \$0.6 million in 2011 to \$2.9 million from \$2.3 million in 2010. Gross profit as a percent of net sales increased to 20.0% in 2011 from 16.7% in 2010, primarily due to a shift in sales toward higher margin customers.

***Selling, General and Administrative Expenses***

SG&A expenses for the years ended December 31, 2011 and 2010 were as follows:

|                            | September 30,<br>Year ended December 31,<br>2011 | September 30,<br>(Dollars in thousands)<br>December 31,<br>2010 | September 30,<br>Amount<br>Change | September 30,<br>% |
|----------------------------|--------------------------------------------------|-----------------------------------------------------------------|-----------------------------------|--------------------|
| Selling expenses           | \$ 86,520                                        | \$ 88,240                                                       | \$ (1,720)                        | (1.9)%             |
| General and administrative | 94,771                                           | 91,781                                                          | 2,990                             | 3.3                |
| <b>Total SG&amp;A</b>      | <b>\$ 181,291</b>                                | <b>\$ 180,021</b>                                               | <b>\$ 1,270</b>                   | <b>0.7</b>         |

Total SG&A expenses were \$181.3 million or 57.6% of net sales and \$180.0 million or 56.8% of net sales in 2011 and 2010, respectively. Selling expenses consist of commissions paid to our independent sales representatives, employee sales expenses and related expenses to support our sales efforts. Selling expenses decreased to \$86.5 million in 2011 from \$88.2 million in 2010 and decreased as a percent of sales to 27.5% in 2011 from 27.9% in 2010, reflecting lower health insurance costs and a shift in our customer mix to larger strategic accounts which tend to result in lower commissions.

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses increased \$3.0 million or 3.3%. An increase in ERP implementation costs of \$3.2 million primarily drove the increase. Additionally, we incurred higher temporary labor, consulting and overtime costs in the second half of the year to address the increase in the number of customer service calls and to reduce backorder levels following the launch of our ERP system. These higher operating costs were partially offset by lower incentive compensation expenses due to our operating performance and decline of our stock price.

***Severance Expenses***

Severance expenses were \$1.6 million in 2011 compared to \$3.6 million in 2010. Severance includes the restructuring of some of our managerial responsibilities resulting in the elimination of certain positions within both the sales and corporate teams.

***Gain on Sale of Assets***

In 2010, we sold our previously discontinued Dallas, Texas distribution center for \$2.0 million, resulting in a gain of \$1.7 million.

***Other Operating Expenses (Income)***

In 2011, the Company recorded a \$1.2 million expense for the estimated cost of settling an employment tax matter related to the classification of the sales representatives of one of the Company's subsidiaries as independent contractors. Also in 2011, we recorded an impairment charge of \$1.1 million related to certain long-term assets of our OEM segment.

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In 2010, we recorded a \$4.1 million benefit related to proceeds received from a settlement of litigation.

### Interest Expense

Interest expense increased \$0.3 million to \$0.7 million in 2010 from \$0.4 million in 2010, primarily due to interest assessed on unclaimed property settlements in 2011.

### Other Income

Other income was relatively unchanged at \$0.1 million in 2011 compared to \$0.2 million in 2010.

### Income Tax Expense

The effective tax rates for continuing operations for 2011 and 2010 were 27.8% and 42.6%, respectively. The 2011 tax rate decreased from 2010 primarily due to the effect of permanent tax differences on pre tax operating loss reported in 2011 compared to pre tax operating income reported in 2010.

### Operating Income (Loss)

Operating income (loss) in 2011 was significantly impacted in the second half of the year by the implementation of our ERP system reflected in lower sales and lower gross margins and higher operating expenses as a percent of sales. The following represents our quarterly results for 2011:

|                                            | September 30,<br>Dec. 31 | September 30,<br>(Dollars in thousands)<br>2011 Quarter Ended<br>Sep. 30 | September 30,<br>Jun. 30 | September 30,<br>Mar. 31 |
|--------------------------------------------|--------------------------|--------------------------------------------------------------------------|--------------------------|--------------------------|
| Net sales                                  | \$ 72,860                | \$ 75,366                                                                | \$ 84,154                | \$ 82,579                |
| Gross profit                               | 38,993                   | 42,546                                                                   | 48,299                   | 49,939                   |
| Gross profit percentage                    | 53.5%                    | 56.5%                                                                    | 57.4%                    | 60.5%                    |
| Operating expenses:                        |                          |                                                                          |                          |                          |
| Selling, general & administrative expenses | \$ 44,265                | \$ 45,335                                                                | \$ 46,242                | \$ 45,449                |
| Severance expense                          | 122                      | 282                                                                      | 465                      | 745                      |
| Loss on sale of assets                     | 22                       |                                                                          |                          |                          |
| Other operating expenses                   | 2,346                    |                                                                          |                          |                          |
| Total operating expenses                   | \$ 46,755                | \$ 45,617                                                                | \$ 46,707                | \$ 46,194                |
| Operating income (loss)                    | \$ (7,762)               | \$ (3,071)                                                               | \$ 1,592                 | \$ 3,745                 |

**Table of Contents****RESULTS OF OPERATIONS FOR 2010 AS COMPARED TO 2009*****Net Sales and Gross Profit***

Sales and gross profit results for the years ended December 31, 2010 and 2009 were as follows:

|                            | September 30,<br>Year ended December 31,<br>2010 | September 30,<br>(Dollars in thousands)<br>December 31,<br>2009 | September 30,<br>Amount | September 30,<br>Change<br>% |
|----------------------------|--------------------------------------------------|-----------------------------------------------------------------|-------------------------|------------------------------|
| <b>Net sales</b>           |                                                  |                                                                 |                         |                              |
| MRO                        | \$ 303,138                                       | \$ 289,715                                                      | \$ 13,423               | 4.6%                         |
| OEM                        | 13,642                                           | 12,054                                                          | 1,588                   | 13.2                         |
| Consolidated               | \$ 316,780                                       | \$ 301,769                                                      | \$ 15,011               | 5.0                          |
| <b>Gross profit</b>        |                                                  |                                                                 |                         |                              |
| MRO                        | \$ 192,544                                       | \$ 184,430                                                      | \$ 8,114                | 4.4%                         |
| OEM                        | 2,282                                            | 1,129                                                           | 1,153                   | 102.1                        |
| Consolidated               | \$ 194,826                                       | \$ 185,559                                                      | \$ 9,267                | 5.0                          |
| <b>Gross profit margin</b> |                                                  |                                                                 |                         |                              |
| MRO                        | 63.5%                                            | 63.7%                                                           |                         |                              |
| OEM                        | 16.7                                             | 9.4                                                             |                         |                              |
| Consolidated               | 61.5                                             | 61.5                                                            |                         |                              |

Net sales for 2010 increased 5.0% to \$316.8 million from \$301.8 million in 2009. MRO net sales increased \$13.4 million or 4.6% in 2010 to \$303.1 million from \$289.7 million in 2009, driven by sales increases in the strategic, government and automotive sectors of our business. A modest improvement in the economy also contributed to the net sales increase, particularly in the second half of the year. An improvement in average daily sales per sales representative and average orders per day drove average MRO daily sales from \$1.150 million in 2009 to \$1.203 million in 2010.

OEM net sales increased \$1.6 million or 13.2% in 2010 to \$13.6 million from \$12.1 million in 2009, primarily driven by growth within our existing customer base and the addition of new customers.

Consistent with the increase in sales, overall gross profit increased 5.0% in 2010 to \$194.8 million from \$185.6 million in 2009. As a percent of sales, gross profit margin remained constant for both 2010 and 2009 at 61.5%. MRO gross profit increased \$8.1 million in 2010 to \$192.5 million from \$184.4 million in 2009. As a percent of net sales, MRO gross profit decreased slightly to 63.5% in 2010 from 63.7% in 2009, primarily due to an increased volume of business from strategic customers that generate lower gross margins.

OEM gross profit increased \$1.2 million in 2010 to \$2.3 million from \$1.1 million in 2009. Gross profit as a percent of net sales increased to 16.7% in 2010 from 9.4% in 2009. The increase in the gross profit percentage is primarily attributable to more aggressive pricing of sales contracts and higher sales volume spread over a partially fixed overhead structure.

***Selling, General and Administrative Expenses***

SG&A expenses for the years ended December 31, 2010 and 2009 were as follows:

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|                            | September 30,<br>Year ended<br>2010 | September 30,<br>(Dollars in thousands)<br>December 31,<br>2009 | September 30,<br>Amount | September 30,<br>Change<br>% |
|----------------------------|-------------------------------------|-----------------------------------------------------------------|-------------------------|------------------------------|
| Selling expenses           | \$ 88,240                           | \$ 86,732                                                       | \$ 1,508                | 1.7%                         |
| General and administrative | 91,781                              | 90,689                                                          | 1,092                   | 1.2                          |
| Total SG&A                 | \$ 180,021                          | \$ 177,421                                                      | \$ 2,600                | 1.5                          |

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SG&A expenses were \$180.0 million or 56.8% of net sales and \$177.4 million or 58.8% of net sales in 2010 and 2009, respectively. Selling expenses increased by \$1.5 million in 2010 from 2009. This was primarily driven by the transition of independent district sales managers to full-time employees.

General and administrative expenses increased \$1.1 million or 1.2% from 2009 to 2010. The increase was primarily driven by ERP implementation expenses and higher incentive compensation expense as a result of improved performance and an increase in our stock price. These increases were partially offset by lower legal fees, a full year of savings from the closure of the Dallas, Texas and Charlotte, North Carolina distribution centers in 2009 and a continued effort to streamline our overall cost structure.

### ***Severance Expenses***

Severance expenses were \$3.6 million in 2010 compared to \$6.2 million in 2009. A restructuring of some of our managerial responsibilities focused on improved operating efficiencies in 2010 resulted in the elimination of certain positions within both the sales and corporate teams. In 2009 we reduced the size of our workforce across the organization in response to the economic recession.

### ***Loss (Gain) on Sale of Assets***

In 2010, we sold our previously discontinued Dallas, Texas distribution center for \$2.0 million, resulting in a gain of \$1.7 million.

### ***Other Operating (Income) Expenses***

In 2010, we recorded a \$4.1 million benefit related to proceeds received from a settlement agreement and legal remedies related to the actions of several former sales representatives and the Share Corporation alleging, among other things, breach of contract and interference with our customer relationships. In exchange for the proceeds, we agreed to settle all related claims with Share and the former sales representatives.

In 2009, we recorded an impairment charge of \$0.3 million to reduce the carrying value of certain property, plant and equipment in our OEM segment to fair value. We also incurred \$0.2 million of costs related to the DPA.

### ***Interest Expense***

Interest expense decreased \$0.6 million to \$0.4 million in 2010 from \$1.0 million in 2009 as strong cash flows from operations allowed us to reduce the average balance outstanding on our revolving line of credit during the year.

### ***Other Income***

Other income was \$0.2 million in 2010 compared to \$1.0 million in 2009. Other income in 2009 included a non-recurring \$0.6 million gain on the sale of an investment.

### ***Income Tax Expense***

The effective tax rates for continuing operations for 2010 and 2009 were 42.6% and (36.1)%, respectively. The 2010 effective tax rate reflects the effect of capital losses not expected to be utilized due to the tax impact of the sales of ACS and Rutland and other deferred expenses. The 2009 effective tax rate reflects the effect of the agreement reached with the Internal Revenue Service Appeals Office for the years 2000 through 2003, as well as a decrease in the valuation allowance recorded for the capital loss carryforward.

**Table of Contents****LIQUIDITY AND CAPITAL RESOURCES**

Cash used in operating activities was \$22.9 million in 2011 compared to cash provided by operations of \$11.3 million and \$10.6 million in 2010 and 2009, respectively. In 2011, cash was primarily used to support increased levels of accounts receivable and inventory. The increase in inventory was attributable to ERP issues which negatively affected our procurement process and service level to customers. These issues also led to delays in the collection of our receivables. We are making progress resolving these issues and anticipate a return to more normalized receivable and inventory levels during 2012.

In 2010, cash was primarily generated from operating income and proceeds received from the sale of ACS and Rutland. In 2009, cash was primarily generated through the streamlining of working capital by reducing excess inventories and increased collection of accounts receivable. Cash from operations was net of \$10.0 million in settlement payments in 2010 and 2009, respectively.

Cash used to purchase property, plant and equipment was \$11.1 million, \$10.0 million and \$2.7 million in 2011, 2010 and 2009, respectively. Purchases included \$5.9 million and \$6.5 million for the new ERP system in 2011 and 2010, respectively. Our 2011 capital outlays also included \$1.6 million towards the construction of our new McCook packaging and distribution center and \$0.8 million related to the redevelopment of our web-site. We received \$2.0 million of proceeds from the sale of our Dallas, Texas property in 2010 and \$2.2 million of proceeds from the sale of our Charlotte, North Carolina property in 2009.

Our financing activities included dividends paid to stockholders of \$4.1 million, \$2.2 million and \$2.7 million in 2011, 2010 and 2009, respectively, and net pay down of our line of credit of \$7.7 million in 2009.

Our amended credit agreement ( Credit Agreement ) provides for a total borrowing capacity of \$55.0 million in the form of a revolving line of credit and letters of credit which expires on October 1, 2016. Additionally, we have a one-time option, subject to the bank's consent, to increase the maximum borrowing capacity by an additional \$20.0 million, to \$75.0 million. The applicable interest rate for borrowings under the Credit Agreement are based on our debt-to-EBITDA ratio (as defined) and range from Libor plus 1.25 to 1.85 or Prime minus 1.00 to 0.40 percent, and is secured by cash, accounts receivable and inventory.

The Credit Agreement limits our annual dividend distribution to \$10.0 million and, in addition requires us to make other customary representations, warranties and covenants, and to comply with certain financial covenants. During 2011, the Credit Agreement was amended replacing the previous Debt Service Coverage Ratio (as defined) with a requirement to meet minimum Consolidated EBITDA levels (as defined) on a quarterly basis through the third quarter ended September 30, 2012. The Debt Service Coverage Ratio will be reinstituted for the trailing four quarters ended December 31, 2012 at a minimum of 1.10 to 1.00 and increases to 1.20 to 1.00 for the trailing four quarters ended March 31, 2013 and each quarter thereafter. Additionally, we must comply with a minimum cash plus accounts receivable and inventory to debt ratio and maintain a minimum tangible net worth. On December 31, 2011, we were in compliance with all of the financial covenant levels as detailed below:

| <b>Covenant</b>                                                   | <b>September 30,<br/>Requirement</b> | <b>September 30,<br/>Actual</b> |
|-------------------------------------------------------------------|--------------------------------------|---------------------------------|
| Minimum EBITDA (loss), as defined in the amended Credit Agreement | \$(5.0) million                      | \$(3.7) million                 |
| Minimum cash plus accounts receivable and inventory to debt ratio | 1.75:1.00                            | 55.35:1.00                      |
| Minimum tangible net worth                                        | \$55.0 million                       | \$80.9 million                  |

At December 31, 2011, we had no outstanding balance under the revolving line and \$1.8 million of outstanding letters of credit, leaving borrowing availability of \$53.2 million. We believe that cash provided by operations and the \$55.0 million revolving line of credit will be sufficient to fund our operating requirements, strategic initiatives and capital improvements for the upcoming fiscal year.

**Table of Contents****CONTRACTUAL OBLIGATIONS**

Contractual obligations, including discontinued operations, on December 31, 2011 that require cash payment over future periods are as follows:

|                                    | September 30,<br>Total | September 30,<br>2012 | September 30,<br>(Dollars in thousands)<br>Payments due in years ended December 31,<br>2013 2014 | September 30,<br>2015 2016 | September 30,<br>Thereafter |
|------------------------------------|------------------------|-----------------------|--------------------------------------------------------------------------------------------------|----------------------------|-----------------------------|
| Operating leases                   | \$ 12,982              | \$ 1,170              | \$ 2,262                                                                                         | \$ 2,045                   | \$ 7,505                    |
| Build-to-suit lease                | 14,800                 | 623                   | 2,566                                                                                            | 2,724                      | 8,887                       |
| Capital leases                     | 416                    | 237                   | 179                                                                                              |                            |                             |
| Security bonus plan (1)            | 24,198                 | 888                   |                                                                                                  |                            | 23,310                      |
| Purchase commitments               | 14,554                 | 14,554                |                                                                                                  |                            |                             |
| Deferred compensation              | 11,985                 | 2,706                 | 1,858                                                                                            | 1,308                      | 6,113                       |
| Severance obligation               | 1,282                  | 1,187                 | 95                                                                                               |                            |                             |
| Long term incentive plan (2)       | 225                    | 225                   |                                                                                                  |                            |                             |
| Total contractual cash obligations | \$ 80,442              | \$ 21,590             | \$ 6,960                                                                                         | \$ 6,077                   | \$ 45,815                   |

- (1) Payments to participants of the security bonus plan are made on a lump sum basis at time of separation from the Company. Payouts for known separation dates have been included in the scheduled year of payout, while payouts for unknown separation dates are reflected in the thereafter column.
- (2) Payments related to the long term incentive plans are subject to increase or decrease based on the future operating performance of the Company.

**OFF-BALANCE SHEET ARRANGEMENTS**

In 2011, we entered into a 10-year build-to-suit lease for our new McCook packaging and distribution center which expires in June 2022 and includes total future minimum lease payments of \$14.8 million. We also entered into an 11-year operating lease for our new headquarters which expires in March 2023 and includes total future minimum lease payments of \$12.2 million. As of December 31, 2011, we had total future minimum operating and build-to-suit lease commitments of \$27.8 million. We also had contractual commitments to purchase \$14.6 million of product from our suppliers and contractors in 2012.

**CRITICAL ACCOUNTING POLICIES**

We have disclosed our significant accounting policies in Note 2 to the Consolidated Financial Statements. The following provides supplemental information to these accounting policies as well as information on the accounts requiring more significant estimates.

*Allowance for Doubtful Accounts* We evaluate the collectability of accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer's inability to meet its financial obligations (e.g., bankruptcy filings, substantial down-grading of credit ratings), a specific reserve for bad debts is recorded against amounts due to reduce the receivable to the amount we believe will be collected. For all other customers, we recognize reserves for bad debts based on our historical experience of bad debt write-offs as a percent of accounts receivable outstanding. If circumstances change (e.g., higher than expected defaults or an unexpected material adverse change in a major customer's ability to meet its financial obligations), the estimates of the recoverability of amounts due to us could be revised by a material amount. At December 31, 2011, our allowance reserve was 4.2% of our gross accounts receivables outstanding. A hypothetical change of one percent to our reserve allowance as a percent of our gross accounts receivable would have affected our annual doubtful accounts expense by approximately \$0.6 million.





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***Inventory Reserves*** Inventories consist principally of finished goods and are stated at the lower of cost (first-in-first-out method) or market. Most of our products are not exposed to the risk of obsolescence due to technology changes. However, some of our products do have a limited shelf life, and from time to time we add and remove items from our catalogs, brochures or website for marketing and other purposes. In addition, we carry varying levels of customer specific inventory.

To reduce our inventory to a lower of cost or market value, we record a reserve for slow-moving and obsolete inventory based on historical experience and monitoring current inventory activity. We use estimates to determine the necessity of recording these reserves based on periodic detailed analysis reviews using both qualitative and quantitative factors. As part of this analysis, we consider several factors including the inventories' length of time on hand, historical sales, product shelf life, product life cycle, product classification, and product obsolescence. In general, depending on product classification, we reserve inventory with low turnover at higher rates than inventory with high turnover. Our policy is to not re-value inventory to the original cost basis subsequent to establishing a new cost basis.

At December 31, 2011, our inventory reserve was \$5.0 million, equal to approximately 8% of our total inventory. A hypothetical change of one percent to our reserve allowance as a percent of total inventory would have affected our cost of goods sold by \$0.6 million.

***Income Taxes*** Deferred tax assets or liabilities reflect temporary differences between amounts of assets and liabilities for financial and tax reporting. Such amounts are adjusted, as appropriate, to reflect changes in enacted tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is established to offset any deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The determination of the amount of a valuation allowance to be provided on recorded deferred tax assets involves estimates regarding (1) the timing and amount of the reversal of taxable temporary differences, (2) expected future taxable income, (3) the impact of tax planning strategies and (4) the ability to carry back deferred tax assets to offset prior taxable income. In assessing the need for a valuation allowance, we consider all available positive and negative evidence, including past operating results, projections of future taxable income and the feasibility of ongoing tax planning strategies. The projections of future taxable income include a number of estimates and assumptions regarding our volume, pricing and costs. Additionally, valuation allowances related to deferred tax assets can be impacted by changes to tax laws. Significant judgment is required in determining income tax provisions as well as deferred tax asset and liability balances, including the estimation of valuation allowances and the evaluation of tax positions.

We recognize the benefit of tax positions when a benefit is more likely than not (i.e., greater than 50% likely) to be sustained on its technical merits. Recognized tax benefits are measured at the largest amount that is more likely than not to be sustained, based on cumulative probability, in final settlement of the position. We recognize interest and penalties related to unrecognized tax benefits as a component of income tax expense.

***Goodwill Impairment*** Goodwill, all of which is included in our MRO segment, is tested annually during the fourth quarter, or when events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Impairment of goodwill is evaluated using a two-step process. First the fair value of the reporting unit is compared with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired, and thus, the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

We estimate the fair value of the MRO segment using a market approach, which relies on the market value of companies that are engaged in the same line of business. We also prepare a discounted cash flow (DCF) analysis based on our operating plan to determine a range of fair values. The DCF model relies on a number of assumptions that have a significant effect on the resulting fair value calculation and may change in future periods. Estimated future cash flows are affected both by future economic conditions outside the control of management and operating results directly related to management's execution of our business strategy. Our DCF model is also affected by our estimate of a discount rate that is consistent with the weighted average cost of capital that we anticipate a potential market participant would use.

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We then assess the reasonableness of our estimate of the fair value of the MRO segment. This is done by applying the same valuation methodology and estimates described above to the entire Company and reconciling the resulting estimated fair value of the consolidated Company to its market capitalization based on the trading range of the Company's stock near the measurement date.

Currently, the calculated fair value of the MRO segment exceeds its carrying value by \$38 million and, therefore, is not considered impaired. Changes in the assumptions used in our DCF calculation could have a material effect on the fair value estimate and could change our assessment of impairment. A hypothetical 10% decrease in the estimated future annual cash flows generated by the MRO segment would decrease its estimated fair value by approximately \$9 million. A hypothetical 100 basis point increase in the discount rate would decrease its estimated fair value by approximately \$15 million.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

One of our subsidiaries is located and operates in Canada using the Canadian dollar as its functional currency. Operating results are translated into U.S. dollars when consolidated into our financial statements. Therefore, we are exposed to market risk relating to the change in the value of the Canadian dollar relative to the U.S. dollar. A hypothetical 10% change in the Canadian foreign currency exchange rate would have affected our 2011 net sales by \$3.0 million and net assets by \$1.7 million.

Certain compensation awards have been granted to our directors, officers and key employees that are payable in cash, based upon the market price of our common stock. These awards are re-measured each reporting period and the effect of the change in the share price is reflected in our operating results. A hypothetical 10% change in the price of our common stock on December 31, 2011 would have affected our 2011 operating income by \$0.2 million.

A number of our current and past employees have opted to defer a portion of their earned compensation to be paid at a future date. These individuals have the ability to invest the deferred compensation in one or more portfolios that track the performance of various mutual funds. As of December 31, 2011, we recorded a \$12.0 million liability equal to the market value amount of the funds owed. Additionally, we have invested funds in life insurance policies on certain executives. The cash surrender value of the policies is invested in various investment instruments and the \$15.5 million market value of these investment instruments has been recorded as an asset on our financial statements as of December 31, 2011. The change in the market value of the funds supporting our deferred compensation plan and the cash surrender value of the life insurance policies is recorded as a component of income and a hypothetical 10% increase or decrease in the investment portfolios of both the cash value of life insurance asset and the deferred compensation liability would have affected our 2011 operating loss by \$0.4 million.

We are exposed to market risk relating to increased commodity and energy costs affecting the production costs of our vendors. These vendors typically look to pass their increased costs along to us and if we are unable to fully pass these costs through to our customers or to modify our activities, the impact would have an adverse effect on our operating profit margins.

On December 31, 2011, we had no borrowings outstanding on our revolving line of credit. However, in future years, operating results may be exposed to the market risk of fluctuations in the variable interest rate charged on our revolving line of credit.

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

The following information is presented in this item:

|                                                                                                                        | <b>September 30,</b> |
|------------------------------------------------------------------------------------------------------------------------|----------------------|
| <u>Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements</u>                    | 30                   |
| <u>Consolidated Balance Sheets as of December 31, 2011 and 2010</u>                                                    | 31                   |
| <u>Consolidated Statements of Operations for the Years ended December 31, 2011, 2010 and 2009</u>                      | 32                   |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years ended December 31, 2011, 2010 and 2009</u> | 33                   |
| <u>Consolidated Statements of Cash Flows for the Years ended December 31, 2011, 2010 and 2009</u>                      | 34                   |
| <u>Notes to Consolidated Financial Statements</u>                                                                      | 35                   |
| <u>Schedule II - Valuation and Qualifying Accounts</u>                                                                 | 53                   |

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**Report of Independent Registered Public Accounting Firm  
on Consolidated Financial Statements**

To the Stockholders and Board of Directors

Lawson Products, Inc.

We have audited the accompanying consolidated balance sheets of Lawson Products, Inc. as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lawson Products, Inc. at December 31, 2011 and 2010, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Lawson Products, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 1, 2012, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois

March 1, 2012

**Table of Contents****Lawson Products, Inc.****Consolidated Balance Sheets**

(Dollars in thousands)

|                                                                                                | September 30,<br>December 31,<br>2011 | September 30,<br>December 31,<br>2010 |
|------------------------------------------------------------------------------------------------|---------------------------------------|---------------------------------------|
| <b>ASSETS</b>                                                                                  |                                       |                                       |
| Current assets:                                                                                |                                       |                                       |
| Cash and cash equivalents                                                                      | \$ 2,116                              | \$ 40,566                             |
| Accounts receivable, less allowance for doubtful accounts of \$1,912 and \$1,085, respectively | 43,239                                | 33,398                                |
| Inventories                                                                                    | 55,498                                | 47,167                                |
| Miscellaneous receivables and prepaid expenses                                                 | 7,064                                 | 8,905                                 |
| Deferred income taxes                                                                          | 5,716                                 | 4,251                                 |
| Discontinued operations                                                                        | 410                                   | 619                                   |
| Total current assets                                                                           | 114,043                               | 134,906                               |
| Property, plant and equipment, less accumulated depreciation and amortization                  | 52,702                                | 44,442                                |
| Cash value of life insurance                                                                   | 15,490                                | 15,660                                |
| Deferred income taxes                                                                          | 11,864                                | 11,492                                |
| Goodwill                                                                                       | 28,148                                | 28,307                                |
| Other assets                                                                                   | 501                                   | 1,577                                 |
| Total assets                                                                                   | \$ 222,748                            | \$ 236,384                            |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|                                                   |           |           |
|---------------------------------------------------|-----------|-----------|
| Current liabilities:                              |           |           |
| Accounts payable                                  | \$ 22,967 | \$ 18,195 |
| Accrued expenses and other liabilities            | 28,231    | 35,348    |
| Discontinued operations                           | 681       | 2,008     |
| Total current liabilities                         | 51,879    | 55,551    |
| Noncurrent liabilities and deferred credits:      |           |           |
| Security bonus plan                               | 23,310    | 25,602    |
| Deferred compensation                             | 9,279     | 10,792    |
| Other                                             | 4,108     | 1,574     |
|                                                   | 36,697    | 37,968    |
| Commitments and contingencies                     | Note 12   |           |
| Stockholders' equity:                             |           |           |
| Preferred stock, \$1 par value:                   |           |           |
| Authorized 500,000 shares, Issued and outstanding | None      |           |
| Common stock, \$1 par value:                      |           |           |

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|                                                          |            |    |         |
|----------------------------------------------------------|------------|----|---------|
| Authorized 35,000,000 shares,                            |            |    |         |
| Issued 8,580,753 and 8,534,028 shares                    |            |    |         |
| Outstanding 8,574,291 and 8,531,325 shares               |            |    |         |
|                                                          | 8,581      |    | 8,534   |
| Capital in excess of par value                           | 6,210      |    | 5,328   |
| Retained earnings                                        | 117,371    |    | 126,098 |
| Treasury stock 6,462 and 2,703 shares held, respectively | (130)      |    | (70)    |
| Accumulated other comprehensive income                   | 2,140      |    | 2,975   |
| Total stockholders equity                                | 134,172    |    | 142,865 |
| Total liabilities and stockholders equity                | \$ 222,748 | \$ | 236,384 |

See notes to Consolidated Financial Statements

**Table of Contents****Lawson Products, Inc.****Consolidated Statements of Operations****(Dollars in thousands, except per share data)**

|                                                              | September 30,<br>2011 | September 30,<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|--------------------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|
| Net sales                                                    | \$ 314,959            | \$ 316,780                                       | \$ 301,769            |
| Cost of goods sold                                           | 135,182               | 121,954                                          | 116,210               |
| Gross profit                                                 | 179,777               | 194,826                                          | 185,559               |
| Operating expenses:                                          |                       |                                                  |                       |
| Selling, general and administrative expenses                 | 181,291               | 180,021                                          | 177,421               |
| Severance expenses                                           | 1,614                 | 3,629                                            | 6,228                 |
| Loss (gain) on sale of assets                                | 22                    | (1,701)                                          | 16                    |
| Other operating expenses (income)                            | 2,346                 | (4,050)                                          | 481                   |
| Operating expenses                                           | 185,273               | 177,899                                          | 184,146               |
| Operating income (loss)                                      | (5,496)               | 16,927                                           | 1,413                 |
| Interest expense                                             | (681)                 | (391)                                            | (1,037)               |
| Other income, net                                            | 101                   | 160                                              | 1,029                 |
| Income (loss) from continuing operations before income taxes | (6,076)               | 16,696                                           | 1,405                 |
| Income tax (benefit) expense                                 | (1,687)               | 7,106                                            | (507)                 |
| Income (loss) from continuing operations                     | (4,389)               | 9,590                                            | 1,912                 |
| Discontinued operations, net                                 | (235)                 | (2,653)                                          | (4,648)               |
| Net income (loss)                                            | \$ (4,624)            | \$ 6,937                                         | \$ (2,736)            |
| Basic income (loss) per share of common stock:               |                       |                                                  |                       |
| Continuing operations                                        | \$ (0.51)             | \$ 1.13                                          | \$ 0.22               |
| Discontinued operations                                      | (0.03)                | (0.32)                                           | (0.54)                |
| Net Income (loss)                                            | \$ (0.54)             | \$ 0.81                                          | \$ (0.32)             |
| Diluted income (loss) per share of common stock:             |                       |                                                  |                       |
| Continuing operations                                        | \$ (0.51)             | \$ 1.12                                          | \$ 0.22               |
| Discontinued operations                                      | (0.03)                | (0.31)                                           | (0.54)                |
| Net Income (loss)                                            | \$ (0.54)             | \$ 0.81                                          | \$ (0.32)             |



See notes to Consolidated Financial Statements

**Table of Contents****Lawson Products, Inc.****Consolidated Statements of Changes in Stockholders' Equity**

(Dollars in thousands)

|                                                | September 30,<br>Common<br>Stock,<br>\$1 par value | September 30,<br>Capital in<br>Excess of<br>Par Value | September 30,<br>Retained<br>Earnings | September 30,<br>Treasury<br>Stock | September 30,<br>Accumulated<br>Other<br>Comprehensive<br>Income (loss) | September 30,<br>Comprehensive<br>Income (loss) |
|------------------------------------------------|----------------------------------------------------|-------------------------------------------------------|---------------------------------------|------------------------------------|-------------------------------------------------------------------------|-------------------------------------------------|
| Balance at January 1,<br>2009                  | \$ 8,522                                           | \$ 4,774                                              | \$ 126,158                            | \$                                 | \$ (710)                                                                |                                                 |
| Net loss                                       |                                                    |                                                       | (2,736)                               |                                    |                                                                         | \$ (2,736)                                      |
| Other comprehensive<br>loss, net of tax:       |                                                    |                                                       |                                       |                                    |                                                                         |                                                 |
| Adjustment for foreign<br>currency translation |                                                    |                                                       |                                       |                                    | 2,166                                                                   | 2,166                                           |
| Comprehensive loss for<br>the year             |                                                    |                                                       |                                       |                                    |                                                                         | \$ (570)                                        |
| Stock based<br>compensation                    |                                                    | 6                                                     |                                       |                                    |                                                                         |                                                 |
| Cash dividends declared                        |                                                    |                                                       | (1,534)                               |                                    |                                                                         |                                                 |
| Balance at December 31,<br>2009                | 8,522                                              | 4,780                                                 | 121,888                               |                                    | 1,456                                                                   |                                                 |
| Net income                                     |                                                    |                                                       | 6,937                                 |                                    |                                                                         | \$ 6,937                                        |
| Other comprehensive<br>income, net of tax:     |                                                    |                                                       |                                       |                                    |                                                                         |                                                 |
| Adjustment for foreign<br>currency translation |                                                    |                                                       |                                       |                                    | 1,519                                                                   | 1,519                                           |
| Comprehensive income<br>for the year           |                                                    |                                                       |                                       |                                    |                                                                         | \$ 8,456                                        |
| Stock based<br>compensation                    | 12                                                 | 548                                                   |                                       |                                    |                                                                         |                                                 |
| Share repurchase                               |                                                    |                                                       |                                       | (70)                               |                                                                         |                                                 |
| Cash dividends declared                        |                                                    |                                                       | (2,727)                               |                                    |                                                                         |                                                 |
| Balance at December 31,<br>2010                | 8,534                                              | 5,328                                                 | 126,098                               | (70)                               | 2,975                                                                   |                                                 |
| Net loss                                       |                                                    |                                                       | (4,624)                               |                                    |                                                                         | \$ (4,624)                                      |
| Other comprehensive<br>loss, net of tax:       |                                                    |                                                       |                                       |                                    |                                                                         |                                                 |
| Adjustment for foreign<br>currency translation |                                                    |                                                       |                                       |                                    | (835)                                                                   | (835)                                           |

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Comprehensive loss for the year \$ (5,459)

|                          |    |     |  |  |         |      |  |  |  |
|--------------------------|----|-----|--|--|---------|------|--|--|--|
| Stock based compensation | 47 | 882 |  |  |         |      |  |  |  |
| Share repurchase         |    |     |  |  |         | (60) |  |  |  |
| Cash dividends declared  |    |     |  |  | (4,103) |      |  |  |  |

Balance at December 31, 2011 \$ 8,581 \$ 6,210 \$ 117,371 \$ (130) \$ 2,140

See notes to Consolidated Financial Statements

**Table of Contents****Lawson Products, Inc.****Consolidated Statements of Cash Flows**

(Dollars in thousands)

|                                                                                                                               | September 30,<br>2011 | September 30,<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|-------------------------------------------------------------------------------------------------------------------------------|-----------------------|--------------------------------------------------|-----------------------|
| <b>Operating activities</b>                                                                                                   |                       |                                                  |                       |
| Net income (loss)                                                                                                             | \$ (4,624)            | \$ 6,937                                         | \$ (2,736)            |
| Loss from discontinued operations                                                                                             | 235                   | 2,653                                            | 4,648                 |
| Income (loss) from continuing operations                                                                                      | (4,389)               | 9,590                                            | 1,912                 |
| Adjustments to reconcile net income (loss) from continuing operations to net cash (used in) provided by operating activities: |                       |                                                  |                       |
| Depreciation and amortization                                                                                                 | 5,704                 | 6,306                                            | 6,507                 |
| Deferred income taxes                                                                                                         | (1,837)               | 5,220                                            | 2,941                 |
| Stock based compensation expense                                                                                              | 61                    | 1,915                                            | 12                    |
| Settlement payment                                                                                                            |                       | (10,000)                                         | (10,000)              |
| Loss (gain) on disposal of property and equipment                                                                             | 22                    | (1,701)                                          | 16                    |
| Changes in operating assets and liabilities:                                                                                  |                       |                                                  |                       |
| Accounts receivable                                                                                                           | (11,422)              | (4,678)                                          | 6,595                 |
| Inventories                                                                                                                   | (8,432)               | (3,539)                                          | 6,278                 |
| Prepaid expenses and other assets                                                                                             | 2,035                 | 2,118                                            | 3,403                 |
| Accounts payable and accrued expenses                                                                                         | (1,156)               | 6,219                                            | (5,532)               |
| Other                                                                                                                         | (3,494)               | (125)                                            | (1,570)               |
| Net cash (used in) provided by operating activities                                                                           | \$ (22,908)           | \$ 11,325                                        | \$ 10,562             |
| <b>Investing activities</b>                                                                                                   |                       |                                                  |                       |
| Purchases of property, plant and equipment                                                                                    | \$ (11,132)           | \$ (10,048)                                      | \$ (2,721)            |
| Proceeds related to sale of businesses, net                                                                                   | 58                    | 27,264                                           |                       |
| Proceeds from sale of property                                                                                                |                       | 2,027                                            | 2,179                 |
| Net cash (used in) provided by investing activities                                                                           | \$ (11,074)           | \$ 19,243                                        | \$ (542)              |
| <b>Financing activities</b>                                                                                                   |                       |                                                  |                       |
| Net payments on revolving line of credit                                                                                      | \$                    | \$                                               | \$ (7,700)            |
| Dividends paid                                                                                                                | (4,098)               | (2,216)                                          | (2,727)               |
| Other                                                                                                                         |                       | (32)                                             | (420)                 |
| Net cash used in financing activities                                                                                         | \$ (4,098)            | \$ (2,248)                                       | \$ (10,847)           |
| <b>Discontinued operations</b>                                                                                                |                       |                                                  |                       |
| Operating cash flows                                                                                                          | \$ (370)              | \$ 3,463                                         | \$ 5,361              |
| Investing cash flows                                                                                                          |                       | (4)                                              | (47)                  |
| Net cash (used in) provided by discontinued operations                                                                        | \$ (370)              | \$ 3,459                                         | \$ 5,314              |

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|                                                  |          |           |          |
|--------------------------------------------------|----------|-----------|----------|
| Increase (decrease) in cash and cash equivalents | (38,450) | 31,779    | 4,487    |
| Cash and cash equivalents at beginning of year   | 40,566   | 8,787     | 4,300    |
| Cash and cash equivalents at end of year         | \$ 2,116 | \$ 40,566 | \$ 8,787 |

See notes to Consolidated Financial Statements

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**Lawson Products, Inc.**

**Notes to Consolidated Financial Statements**

**Note 1 Description of Business**

Lawson Products, Inc. ( Lawson or the Company ) is a North American distributor of products and services to the industrial, commercial, institutional and governmental maintenance, repair and operations ( MRO ) marketplace. The Company also manufactures and distributes specialized component parts to the original equipment manufacturers ( OEM ) marketplace.

**Note 2 Summary of Significant Accounting Policies**

*Principles of Consolidation* The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States and include the accounts and transactions of the Company and its wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. Certain prior period amounts have been reclassified to conform to the current year presentation.

*Revenue Recognition* Net sales includes product sale and billings for freight and handling charges. Sales and associated cost of goods sold are generally recognized when products are shipped and title passes to customers. We accrue for returns based on historical evidence of rates of return.

*Shipping and Handling Fees and Costs* Shipping and handling fees charged to customers totaled \$12.8 million, \$13.0 million and \$12.6 million in 2011, 2010 and 2009, respectively, and are included in the caption Net sales on the Consolidated Statements of Operations. Costs related to shipping and handling fees of \$13.1 million, \$11.0 million and \$10.3 million in 2011, 2010 and 2009, respectively, are included in Cost of goods sold.

*Cash Equivalents* The Company considers all highly liquid investments with a maturity of three months or less when purchased, such as money market funds, to be cash equivalents.

*Allowance for Doubtful Accounts Methodology* The Company evaluates the collectability of accounts receivable based on a combination of factors. In circumstances where the Company is aware of a specific customer s inability to meet its financial obligations (e.g., bankruptcy filings, substantial down-grading of credit ratings), a specific reserve for bad debts is recorded against amounts due to reduce the receivable to the amount the Company reasonably believes will be collected. For all other customers, the Company recognizes reserves for bad debts based on the Company s historical experience of bad debt write-offs as a percent of accounts receivable outstanding. If circumstances change (e.g., higher than expected defaults or an unexpected material adverse change in a major customer s ability to meet its financial obligations), the estimates of the recoverability of amounts due the Company could be revised by a material amount.

*Inventories* Inventories principally consist of finished goods and some raw materials and work in process related to the manufacturing process at ASMP. Inventories are stated at the lower of cost (first-in-first-out method) or market. To reduce inventory to a lower of cost or market value, a reserve is recorded for slow-moving and obsolete inventory based on historical experience and monitoring current inventory activity. Estimates are used to determine the necessity of recording these reserves based on periodic detailed analysis using both qualitative and quantitative factors. As part of this analysis, the Company considers several factors including the inventories length of time on hand, historical sales, product shelf life, product life cycle, product classification and product obsolescence. It is the Company s policy to not re-value inventory to the original cost basis subsequent to establishing a new cost basis.

Inventories that are not considered ready for sale are classified as either raw materials or work in process. All MRO inventory is considered to be in a state ready for sale and classified as finished goods.

*Property, Plant and Equipment* Property, plant and equipment are stated at cost less accumulated depreciation and amortization. Depreciation expense is computed by the straight-line method for buildings and improvements using useful lives of 20 to 30 years and using the straight-line and double declining balance methods for machinery and equipment, furniture and fixtures and vehicles using useful lives of 3 to 10 years. Amortization of capitalized leases is included in depreciation expense. Depreciation expense was \$3.9 million, \$3.7 million and \$4.2 million for 2011, 2010 and 2009, respectively. Capitalized software is amortized over estimated useful lives of 3 to 5 years using the straight-line method. Amortization expense of capitalized software was \$1.7 million, \$2.6 million and \$2.3 million for 2011, 2010 and 2009, respectively.



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### **Lawson Products, Inc.**

#### **Notes to Consolidated Financial Statements**

**Cash Value of Life Insurance** The Company has invested funds in life insurance policies on certain current and former executives. The cash surrender value of the policies is invested in various investment instruments and is recorded as an asset on our financial statements. The change in the cash surrender value of the life insurance policies, which is based on the market value of investment instruments, is recorded as a component of Selling, general and administrative expenses.

**Deferred Compensation** The Company's Executive Deferral Plan ( Deferral Plan ) allows certain executives to defer payment of a portion of their earned compensation. The deferred compensation is recorded in an Account Balance, which is a bookkeeping entry made by the Company to measure the amount due to the participant. The Account Balance is equal to the participant's deferred compensation, adjusted for increases and or decreases in the amount that the participant has designated to one or more bookkeeping portfolios that track the performance of certain mutual funds. Lawson adjusts the deferred compensation liability to equal the participants' Account Balances. The increase or decrease is recorded as a component of Selling, general and administrative expenses.

**Stock-Based Compensation** Compensation based on the share value of the Company's common stock is valued at its fair value at the grant date and the expense is recognized over the vesting period. Fair value is re-measured each reporting period for liability classified awards that may be redeemable in cash. See Note 13 *Stock Compensation Plans*.

**Goodwill** Goodwill represents the cost of business acquisitions in excess of the fair value of identifiable net tangible and intangible assets acquired. Goodwill is allocated to the appropriate reporting unit as reviewed by the Company's chief decision maker responsible for reviewing operating performance and allocating resources. Goodwill is tested annually during the fourth quarter, or when events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Impairment of goodwill is evaluated using a two-step process. First, the fair value of the reporting unit is compared with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired, and thus, the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any.

**Impairment of Long-Lived Assets** The Company reviews its long-lived assets, including property, plant and equipment and intangibles, for impairment whenever events or changes in circumstances indicate that the carrying amounts of these assets may not be recoverable. Recoverability is measured by a comparison of the assets' carrying amount to their expected future undiscounted net cash flows. If such assets are considered to be impaired, the impairment to be recognized is measured based on the amount by which the carrying amount of the asset exceeds its fair value.

**Income Taxes** Deferred tax assets or liabilities reflect temporary differences between amounts of assets and liabilities for financial and tax reporting. Such amounts are adjusted, as appropriate, to reflect changes in enacted tax rates expected to be in effect when the temporary differences reverse. A valuation allowance is established to offset any deferred tax assets if, based upon the available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized. The determination of the amount of a valuation allowance to be provided on recorded deferred tax assets involves estimates regarding (1) the timing and amount of the reversal of taxable temporary differences, (2) expected future taxable income, (3) the impact of tax planning strategies and (4) the ability to carry back deferred tax assets to offset prior taxable income. In assessing the need for a valuation allowance, the Company considers all available positive and negative evidence, including past operating results, projections of future taxable income and the feasibility of ongoing tax planning strategies. The projections of future taxable income include a number of estimates and assumptions regarding our volume, pricing and costs. Additionally, valuation allowances related to deferred tax assets can be impacted by changes to tax laws.

Significant judgment is required in determining income tax provisions and in evaluating tax positions. In the normal course of business, the Company and its subsidiaries are examined by various Federal, State and foreign tax authorities. The Company records the impact of a tax position, if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The Company regularly assesses the potential outcomes of



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### **Lawson Products, Inc.**

#### **Notes to Consolidated Financial Statements**

these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes. The Company continually assesses the likelihood and amount of potential adjustments and adjusts the income tax provision, the current tax liability and deferred taxes in the period in which the facts that give rise to a revision become known.

The Company recognizes the benefit of tax positions when a benefit is more likely than not (i.e., greater than 50% likely) to be sustained on its technical merits. Recognized tax benefits are measured at the largest amount that is more likely than not to be sustained, based on cumulative probability, in final settlement of the position. The Company recognizes interest and penalties related to unrecognized tax benefits as a component of income tax expense.

**Leases** Leases are categorized as either operating or capital leases at inception. Operating lease costs are recognized on a straight-line basis over the term of the lease. An asset and a corresponding liability for the capital lease obligation are established for the cost of capital leases. The capital lease obligation is amortized over the life of the lease. For build-to-suit leases, the Company establishes an asset and liability for the estimated construction costs incurred to the extent that it is involved in the construction of structural improvements or takes construction risk prior to the commencement of the lease. Upon occupancy of facilities under build-to-suit leases, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance.

**Earnings per Share** Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution from the exercise or conversion of outstanding stock options and restricted stock awards into common stock.

**Foreign Currency** The accounts of foreign subsidiaries are measured using the local currency as the functional currency. All balance sheet amounts have been translated into U.S. dollars using the exchange rates in effect at the applicable period end. Income statement amounts have been translated using the average exchange rate for the applicable period. The gains and losses resulting from the changes in exchange rates from the translation of subsidiary accounts in local currency to U.S. dollars have been reported as a component of Accumulated other comprehensive income in the Consolidated Balance Sheets. Foreign currency transaction gains and losses result from the effect of exchange rate changes on transactions denominated in currencies other than the functional currency. These gains and losses are included in the Consolidated Statements of Operations and were immaterial for all years presented.

**Treasury Stock** The Company repurchased 3,759 and 2,703 shares of its common stock in 2011 and 2010, respectively, from employees upon the vesting of restricted stock to offset the income taxes owed by those employees. The Company accounts for treasury stock using the cost method and includes treasury stock as a component of stockholders' equity.

**Use of Estimates** Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

#### ***Recent Accounting Pronouncements***

In June 2011, the FASB issued Accounting Standards Update (ASU) No. 2011-05, an amendment to ASC 220, Comprehensive Income. This accounting standard update eliminates the option to present components of other comprehensive income as part of the statement of equity and requires that the total of comprehensive income, the components of net income, and the components of other comprehensive income be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. It also requires presentation on the face of the financial statements of reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and the components of other comprehensive income are presented. The amendments in this ASU are to be applied retrospectively. This update is effective for fiscal years and interim periods within those years beginning after December 15, 2011. Portions of ASU 2011-05 were amended in December.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

In December, the FASB issued ASU 2011-12, an amendment to certain pending paragraphs from ASU 2011-05. This amendment allowed for companies to defer the effective date of the change in presentation on the face of the financial statements of reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statements where the components of net income and the components of other comprehensive income are presented until the FASB has further deliberated financial statement users need for this information. The effective date for all other amendments put forth in ASU No. 2011-05 are unaffected by this update. This update is effective for fiscal years and interim periods within those years beginning after December 15, 2011.

In September 2011, the FASB issued ASU No. 2011-08, an amendment to ASC 350, Intangibles – Goodwill and Other. The amendment allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity no longer will be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This amendment is effective for goodwill impairment tests performed for fiscal years beginning after December 15, 2011 with early adoption permitted.

The Company has not early adopted these ASUs and does not expect them to have a material impact on its Consolidated Financial Statements.

*Subsequent Events* The Company has evaluated events through the issue date of this Form 10-K and has determined that no reportable events have occurred subsequent to the date of these financial statements.

**Note 3 Inventories**

Components of inventories were as follows:

|                                           | September 30,<br>(Dollars in thousands)<br>December 31, |           |
|-------------------------------------------|---------------------------------------------------------|-----------|
|                                           | 2011                                                    | 2010      |
| Finished goods                            | \$ 56,985                                               | \$ 49,084 |
| Work in progress                          | 1,935                                                   | 1,203     |
| Raw materials                             | 1,624                                                   | 1,591     |
| Total                                     | 60,544                                                  | 51,878    |
| Reserve for obsolete and excess inventory | (5,046)                                                 | (4,711)   |
|                                           | \$ 55,498                                               | \$ 47,167 |

**Note 4 Property, Plant and Equipment**

Components of property, plant and equipment were as follows:

|                            | September 30,<br>(Dollars in thousands)<br>December 31, |          |
|----------------------------|---------------------------------------------------------|----------|
|                            | 2011                                                    | 2010     |
| Land                       | \$ 8,750                                                | \$ 8,781 |
| Buildings and improvements | 49,917                                                  | 49,857   |

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|                                           |           |           |
|-------------------------------------------|-----------|-----------|
| Machinery and equipment                   | 28,767    | 32,062    |
| Capitalized software                      | 21,422    | 9,279     |
| Furniture and fixtures                    | 5,640     | 5,538     |
| Capital leases                            | 3,501     | 3,210     |
| Vehicles                                  | 131       | 247       |
| Construction in progress                  | 8,263     | 8,944     |
|                                           | 126,391   | 117,918   |
| Accumulated depreciation and amortization | (73,689)  | (73,476)  |
|                                           | \$ 52,702 | \$ 44,442 |

Construction in progress at December 31, 2011 includes \$5.6 million related to the construction of the new McCook, Illinois distribution center ( McCook Facility ), \$1.2 million related to the development of a new website and \$1.4 million related to various other business improvement projects.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

The \$5.6 million construction in progress for the McCook Facility includes \$4.0 million related to a build-to-suit lease. Because the Company was directly involved in structural improvements to the McCook Facility and made direct payments for construction costs, under build-to-suit accounting guidance, the Company recorded a \$4.0 million asset and a corresponding \$4.0 million construction liability of which \$0.6 million is included in accrued expenses and other liabilities and \$3.4 million is included in other noncurrent liabilities. Because the recording of the asset and construction liability was a non-cash transaction, it was not reflected in the Consolidated Statements of Cash Flows. When the McCook Facility is occupied, scheduled for 2012, the Company will assess whether the lease arrangement qualifies for sales recognition under sale-leaseback accounting guidance.

The December 31, 2010 construction in progress includes \$6.5 million related to the new ERP system.

**Note 5 Impairment of Long-Lived Assets**

In 2010, the Company stated that it was evaluating strategic alternatives regarding its ASMP operations. Although the Company has not committed to a plan to divest ASMP, management believes it would be more likely than not that ASMP would be sold or otherwise disposed of significantly before the end of its previously estimated useful life. Therefore, the Company reviewed the recoverability of ASMP's long-lived assets.

In performing the review for recoverability, the Company determined that the future expected undiscounted cash flows of ASMP were less than the carrying amount of the assets, indicating the assets had been impaired. The amount of impairment was then measured based on the amount by which the carrying amount of ASMP's assets exceeded its fair value which was determined by an independent assessment of the amount the assets would be worth to a willing buyer in an open market. Accordingly, in 2011, the Company recorded an impairment charge of \$1.1 million related to property, plant and equipment in the OEM segment.

The Company had previously recorded a \$0.3 million impairment to OEM property, plant and equipment in 2009.

**Note 6 Goodwill**

The Company reviews goodwill annually during the fourth quarter, or when events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying value. Goodwill impairment is deemed to exist if the carrying amount of a reporting unit exceeds its estimated fair value and the goodwill impairment charge, if any, is measured as the difference between the carrying amount of the goodwill as compared to its estimated fair value.

In 2011, the Company reviewed its \$28.1 million goodwill balance, all of which relates to the MRO segment, due to a 2001 acquisition. The Company estimated the fair value of the MRO segment using a market approach, which relies on the market value of companies that are engaged in the same line of business and also prepared a discounted cash flow (DCF) analysis based on its operating plan to determine a range of fair values. The Company then reconciled the estimated fair value of the MRO segment to the market capitalization of the consolidated Company based on the trading range of the Company's stock. After reviewing the analysis, the Company concluded that the calculated fair value of the MRO segment exceeded its carrying value by \$38 million and, therefore, the goodwill was not considered impaired.

Goodwill activity in 2011 and 2010 was as follows:

|                        | September 30,<br>(Dollars in thousands) |           |
|------------------------|-----------------------------------------|-----------|
|                        | December 31,<br>2011                    | 2010      |
| Beginning balance      | \$ 28,307                               | \$ 27,957 |
| Translation adjustment | (159)                                   | 350       |

|                |    |        |    |        |
|----------------|----|--------|----|--------|
| Ending balance | \$ | 28,148 | \$ | 28,307 |
|----------------|----|--------|----|--------|

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 7 Income Taxes**

Income (loss) from continuing operations before income taxes consisted of the following:

|               | September 30,<br>2011 | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|---------------|-----------------------|----------------------------------------------------------------------------|-----------------------|
| United States | \$ (5,100)            | \$ 14,269                                                                  | \$ 2,115              |
| Canada        | (976)                 | 2,427                                                                      | (710)                 |
|               | \$ (6,076)            | \$ 16,696                                                                  | \$ 1,405              |

Provision (benefit) for income taxes from continuing operations for the years ended December 31, consisted of the following:

|                                       | September 30,<br>2011 | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|---------------------------------------|-----------------------|----------------------------------------------------------------------------|-----------------------|
| Current income tax expense (benefit): |                       |                                                                            |                       |
| U.S. Federal                          | \$ 464                | \$ 3,681                                                                   | \$ (2,491)            |
| U.S. state                            | 295                   | 987                                                                        | 77                    |
| Canada                                | (190)                 | 366                                                                        | (102)                 |
| Total                                 | \$ 569                | \$ 5,034                                                                   | \$ (2,516)            |

Deferred income tax expense (benefit):

|              |            |          |          |
|--------------|------------|----------|----------|
| U.S. Federal | \$ (2,187) | \$ 1,648 | \$ 2,065 |
| U.S. state   | (155)      | 217      | 55       |
| Canada       | 86         | 207      | (111)    |
| Total        | \$ (2,256) | \$ 2,072 | \$ 2,009 |

Total income tax expense (benefit):

|              |            |          |          |
|--------------|------------|----------|----------|
| U.S. Federal | \$ (1,723) | \$ 5,329 | \$ (426) |
| U.S. state   | 140        | 1,204    | 132      |
| Canada       | (104)      | 573      | (213)    |
| Total        | \$ (1,687) | \$ 7,106 | \$ (507) |

The reconciliation between the effective income tax rate and the statutory federal rate for continuing operations was as follows:

|                                     | September 30,<br>2011 | September 30,<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|-------------------------------------|-----------------------|--------------------------------------------------|-----------------------|
| Statutory Federal rate              | 35.0%                 | 35.0%                                            | 35.0%                 |
| Increase (decrease) resulting from: |                       |                                                  |                       |
| State and local taxes, net          | (1.6)                 | 1.2                                              | 10.0                  |
| Executive life insurance            | (1.0)                 | (1.8)                                            | (35.0)                |
| Fines and penalties                 | 0.3                   | (0.2)                                            | 13.0                  |
| Meals & entertainment               | (3.0)                 | 0.8                                              | 7.8                   |
| Capital loss carryforward           |                       | 3.7                                              | 73.6                  |
| Deferred tax expense                | 1.0                   | 1.2                                              |                       |
| Change in valuation allowance       | (1.0)                 | 4.1                                              | 13.7                  |
| Change in uncertain tax positions   | (1.6)                 | (1.4)                                            | (154.0)               |
| Provision to return differences     | (0.3)                 | 1.4                                              | (1.9)                 |
| Other items, net                    |                       | (1.4)                                            | 1.7                   |
| Provision for income taxes          | 27.8%                 | 42.6%                                            | (36.1)%               |

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

Income taxes paid for the years ended December 31, 2011, 2010, and 2009 amounted to \$2.6 million, \$5.3 million and \$2.8 million, respectively. In 2011 and 2010, the Company received \$3.3 million and \$5.8 million, respectively, in income tax refunds primarily related to income tax overpayments from prior years.

At December 31, 2011, the Company had \$4.8 million of tax assets for net operating losses and tax credit carryforwards. The U.S. Federal carryforwards consist of \$3.5 million of net operating losses which are subject to expiration in 2030 and \$0.5 million of foreign tax credit carryforwards which are subject to expiration in 2020. In addition, the Company had \$0.8 million of state net operating loss carryforwards which expire at varying dates through 2030.

The Company had valuation allowances of \$0.9 million on both December 31, 2011 and 2010 which relate to certain state net operating losses and foreign tax credit carryforwards, the realization of which the Company believes is less than more likely than not.

Deferred income tax assets and liabilities contain the following temporary differences:

|                                             | September 30,<br>(Dollars in thousands)<br>December 31, |           |
|---------------------------------------------|---------------------------------------------------------|-----------|
|                                             | 2011                                                    | 2010      |
| <b>Deferred tax assets:</b>                 |                                                         |           |
| Compensation and benefits                   | \$ 16,048                                               | \$ 17,689 |
| Net operating loss carryforward             | 4,286                                                   | 2,380     |
| Inventory reserve                           | 2,472                                                   | 2,432     |
| Accounts receivable reserve                 | 723                                                     | 399       |
| Property, plant and equipment               | 879                                                     |           |
| Other                                       | 1,147                                                   | 1,165     |
| Total deferred tax assets                   | 25,555                                                  | 24,065    |
| Valuation allowance for deferred tax assets | (938)                                                   | (875)     |
| Net deferred tax assets                     | 24,617                                                  | 23,190    |
| <b>Deferred tax liabilities:</b>            |                                                         |           |
| Goodwill                                    | 6,557                                                   | 5,984     |
| Property, plant and equipment               |                                                         | 572       |
| Other                                       | 480                                                     | 891       |
| Total deferred liabilities                  | 7,037                                                   | 7,447     |
| Total net deferred assets                   | \$ 17,580                                               | \$ 15,743 |
| <b>Net deferred tax assets:</b>             |                                                         |           |
| Net current deferred income taxes           | \$ 5,716                                                | \$ 4,251  |
| Net noncurrent deferred income taxes        | 11,864                                                  | 11,492    |



\$ 17,580 \$ 15,743

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

|                                             | September 30,<br>(Dollars in thousands)<br>December 31,<br>2011 | September 30,<br>2010 |
|---------------------------------------------|-----------------------------------------------------------------|-----------------------|
| Balance at beginning of year                | \$                                                              | \$ 1,230              |
| Additions for tax positions of current year | 92                                                              |                       |
| Settlements                                 |                                                                 | (1,230)               |
| Balance at end of year                      | \$ 92                                                           | \$                    |

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

The recognition of the unrecognized tax benefits would have a favorable effect 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 December 31, 2011 balance of unrecognized tax benefits represent tax positions that could significantly change during the next twelve months.

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 December 31, 2011, the Company was subject to income tax examinations in various jurisdictions for the tax years 2006 through 2010. During 2011, the Company completed U.S. Federal income tax examinations through tax year 2008.

**Note 8 Accrued Expenses and Other Liabilities**

Accrued expenses and other liabilities consisted of the following:

|                                                     | September 30,<br>(Dollars in thousands)<br>December 31,<br>2011 | September 30,<br>December 31,<br>2010 |
|-----------------------------------------------------|-----------------------------------------------------------------|---------------------------------------|
| Accrued compensation                                | \$ 9,573                                                        | \$ 13,912                             |
| Accrued profit sharing                              | 2,424                                                           | 2,356                                 |
| Accrued and withheld taxes, other than income taxes | 2,226                                                           | 2,584                                 |
| Accrued health benefits                             | 1,234                                                           | 1,145                                 |
| Accrued severance                                   | 1,187                                                           | 2,229                                 |
| Cash dividends payable                              | 1,027                                                           | 1,023                                 |
| Accrued stock based compensation                    | 910                                                             | 2,566                                 |
| Employment tax matter                               | 1,200                                                           |                                       |
| Construction in progress liability                  | 623                                                             |                                       |
| Other                                               | 7,827                                                           | 9,533                                 |
|                                                     | \$ 28,231                                                       | \$ 35,348                             |

**Note 9 Revolving Line of Credit**

The Company has a credit agreement as amended ( Credit Agreement ) with The PrivateBank and Trust Company as agent and lender. The Credit Agreement provides for a total borrowing capacity of \$55.0 million in the form of a revolving line of credit and letters of credit and expires on October 1, 2016. Additionally, the Company has a one-time option, subject to the agent's consent, to increase the maximum borrowing capacity by an additional \$20.0 million, thus increasing the maximum borrowing capacity to \$75.0 million.

The applicable interest rate margins for borrowings are based on the Company's debt to EBITDA ratio and range from Libor plus 1.25 to 1.85 or Prime minus 1.00 to 0.40 percent. The Credit Agreement is secured by cash, accounts receivable and inventory.

The Credit Agreement limits the annual dividend distribution to \$10.0 million and, in addition to other customary representations, warranties and covenants, it requires the Company to comply with certain financial covenants. During 2011 the Credit Agreement was amended so that the previous Debt Service Coverage Ratio was replaced with a requirement to meet minimum Consolidated EBITDA levels (as defined) on a quarterly basis through the third quarter ended September 30, 2012. The Debt Service Coverage Ratio will be reinstituted for the trailing four quarters ended December 31, 2012 at a minimum of 1.10 to 1.00 and increases to 1.20 to 1.00 for the trailing four quarters ended March 31, 2013 and each quarter thereafter. Additionally, the Company must comply with a minimum cash plus accounts receivable and inventory to debt ratio and maintain a minimum tangible net worth. On December 31, 2011, the Company was in compliance with all of the financial covenant levels as detailed below:



**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

| <b>Covenant</b>                                                   | <b>Requirement</b> | <b>Actual</b>    |
|-------------------------------------------------------------------|--------------------|------------------|
| Minimum EBITDA (loss), as defined in the amended Credit Agreement | \$ (5.0) million   | \$ (3.7) million |
| Minimum cash plus accounts receivable and inventory to debt ratio | 1.75:1.00          | 55.35:1.00       |
| Minimum tangible net worth                                        | \$ 55.0 million    | \$ 80.9 million  |

At December 31, 2011, the Company had no outstanding balance under the revolving line and \$1.8 million of outstanding letters of credit, leaving borrowing availability of \$53.2 million. The Company paid interest of \$0.1 million, \$0.2 million and \$0.3 million in 2011, 2010 and 2009, respectively. The weighted average interest rate charged on outstanding loans was 1.52% for the year ended December 31, 2011.

**Note 10 Reserve for Severance**

Severance costs are primarily related to management realignment and reorganization in the MRO segment. The table below reflects the activity in the Company's reserve for severance and related payments.

|                                      | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2011                      2010                      2009 |          |          |
|--------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|----------|----------|
| Beginning balance                    | \$ 3,062                                                                                                                       | \$ 4,086 | \$ 6,012 |
| Charged to earnings current year     | 1,614                                                                                                                          | 3,629    | 6,228    |
| Cash paid and exchange rate variance | (3,394)                                                                                                                        | (4,653)  | (8,154)  |
| Ending balance                       | \$ 1,282                                                                                                                       | \$ 3,062 | \$ 4,086 |

Accrued severance charges were included in the line items of the Consolidated Balance Sheets at December 31, 2011 and 2010 as follows:

|                                        | September 30,<br>(Dollars in thousands)<br>December 31,<br>2011                      2010 |          |
|----------------------------------------|-------------------------------------------------------------------------------------------|----------|
| Accrued severance included in:         |                                                                                           |          |
| Accrued expenses and other liabilities | \$ 1,187                                                                                  | \$ 2,229 |
| Noncurrent other                       | 95                                                                                        | 833      |
| Total accrued severance                | \$ 1,282                                                                                  | \$ 3,062 |

The remaining benefits outstanding as of December 31, 2011 will be fully paid by the end of 2013.

**Note 11 Retirement and Security Bonus Plans**

The Company has a retirement plan with a profit sharing feature for certain sales, office and warehouse employees. The amounts of the Company's annual contributions are determined annually by the Board of Directors. Expenses incurred for the profit sharing plan were \$2.5

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million, \$2.4 million and \$2.0 million for the years ended December 31, 2011, 2010 and 2009, respectively.

The Company has a security bonus plan for the benefit of its independent sales representatives, under the terms of which participants are credited with a percentage of their yearly net commissions. The aggregate amounts credited to participants' accounts vest 25% after five years and an additional 5% vests each year thereafter upon qualification for the plan. For financial reporting purposes, amounts are charged to operations over the vesting period. Expenses incurred for the security bonus plan were \$2.1 million, \$1.9 million and \$2.1 million for the years ended December 31, 2011, 2010 and 2009, respectively.

### **Note 12 Commitments and Contingencies**

#### ***Lease Commitments***

Total rental expense for the years ended December 31, 2011, 2010 and 2009 amounted to \$0.8 million, \$1.4 million and \$1.3 million, respectively. In 2011 the Company entered into a 10 year build-to-suit lease for the new McCook Facility which expires in June 2022 and includes total future minimum lease payments of \$14.8 million.

The Company also entered into an 11 year operating lease for the new headquarters which expires in March 2023 and includes total future minimum lease payments of \$12.2 million.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements**

The Company's future minimum lease commitments, principally for facilities and equipment, as of December 31, 2011, were as follows:

| Year ended             | September 30,       | September 30,                         | September 30,     |
|------------------------|---------------------|---------------------------------------|-------------------|
| December 31,           | Operating<br>Leases | Build-to-suit<br>Lease <sup>(1)</sup> | Capital<br>Leases |
| 2012                   | \$ 1,170            | \$ 623                                | \$ 237            |
| 2013                   | 1,214               | 1,264                                 | 102               |
| 2014                   | 1,048               | 1,302                                 | 77                |
| 2015                   | 1,001               | 1,342                                 |                   |
| 2016                   | 1,044               | 1,382                                 |                   |
| Thereafter             | 7,505               | 8,887                                 |                   |
| Total                  | \$ 12,982           | \$ 14,800                             | \$ 416            |
| Less: Interest portion |                     |                                       | (61)              |
| Liability              |                     |                                       | \$ 355            |

(1) Relates to the McCook, Illinois distribution center lease under construction.

***Litigation, regulatory and tax matters***

The Company is involved in legal actions that arise in the ordinary course of business. It is the opinion of management that the resolution of any currently pending litigation will not have a material adverse effect on the Company's financial position or results of operations.

One of the Company's subsidiaries, Drummond American LLC (Drummond) is under an employment tax examination for the years 2007 and 2008 of the long-standing treatment of its sales representatives as independent contractors. In January 2012, the Company received a Notice of Proposed Adjustment in the amount of \$9.5 million, including penalties, from the IRS challenging Drummond's position that the sales representatives were independent contractors. Although the Company intends to vigorously defend its position for the treatment of its sales representatives as independent contractors the Company established a liability of \$1.2 million as its best estimate of the cost to resolve this matter. An unfavorable outcome of this matter could have a material adverse effect on the Company's business, financial condition and results of operation.

In August 2008, the Company entered into a Deferred Prosecution Agreement (DPA) with the U.S. Attorney's Office in connection with representatives of the Company improperly providing gifts or awards to purchasing agents through the Company's customer loyalty programs. Pursuant to the DPA, the Company agreed to a \$30.0 million penalty. The Company paid \$10.0 million in 2010 and 2009 in accordance with this agreement which expired in 2011.

The Company has identified that it had shipped a limited number of products in violation of certain state environmental regulations. The Company reported its findings to appropriate regulatory agencies. The Company also recalled a limited number of products and is working with state regulators to take appropriate remedial actions to comply with these environmental regulations. At December 31, 2011, the Company had accrued \$0.2 million for penalties and expenses related to environmental matters and at this time, the Company cannot determine if any further expenses may be incurred.

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The Company has identified certain services and benefits that were not properly reported on information returns with respect to its independent sales representatives. The Company has notified the Internal Revenue Service Employment Tax Division and has established procedures to improve proper information reporting practices. At this time, the Company cannot determine if further actions may result from this review. The Company established a liability of \$0.1 million as its best estimate of the cost to resolve this matter.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 13 Stock Compensation Plans**

The Company's 2009 Equity Compensation Plan ( Equity Plan ) provides for the grant of nonqualified and incentive stock options, stock awards and stock units to officers and employees of the Company. The Equity Plan also provides for the grant of option rights and restricted stock to non-employee directors. Under the Equity Plan, 500,000 shares of common stock were available to be awarded with no participant being granted more than 40,000 shares of common stock in any calendar year. The Equity Plan is administered by the Compensation Committee of the Board of Directors, or its designee, which as administrator of the plan, has the authority to select plan participants, grant awards, and determine the terms and conditions of the awards.

The Company has a Stock Performance Rights Plan ( SPR Plan ) that provides for the issuance of Stock Performance Rights that allow non-employee directors, officers and key employees to receive cash awards, subject to certain restrictions, equal to the appreciation of the Company's common stock. The SPR Plan is administered by the Compensation Committee of the Board of Directors.

***Service based awards***

Service based awards require the participants to provide service to the Company over a fixed period of time. The Company has three award types that are based solely on a service condition: Stock Performance Rights ( SPRs ), Restricted Stock Awards ( RSAs ) and Restricted Stock Units ( RSUs ).

**Stock Performance Rights**

SPRs have a seven or ten year life and vest ratably over three years beginning on the first anniversary of the date of the grant. 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. Expense, equal to the fair market value of the SPR at the measurement date, is recorded ratably over the vesting period. Employees and non-employee directors who are retirement eligible, defined as age 65 or older, are permitted to retain their awards after retirement and exercise them during the remaining contractual life. All expense is recognized on the date of grant for SPRs granted to retirement eligible recipients. Compensation expense or benefit is included in Selling, general and administrative expense.

On December 31, 2011, the SPRs outstanding were re-measured at fair value using the Black-Scholes valuation model. This model requires the input of subjective assumptions that may have a significant impact on the fair value estimate. The weighted-average estimated value of SPRs outstanding as of December 31, 2011 was \$3.91 per SPR using the Black-Scholes valuation model with the following assumptions:

|                          | September 30,  |
|--------------------------|----------------|
| Expected volatility      | 50.7% to 74.4% |
| Risk-free rate of return | 0.1% to 0.5%   |
| Expected term (in years) | 0.5 to 3.6     |
| Expected annual dividend | \$0.48         |

The expected volatility was based on the historic volatility of the Company's stock price commensurate with the expected life of the SPR. The risk-free rate of return reflects the interest rate offered for zero coupon treasury bonds over the expected life of the SPR. The expected life represents the period of time that options granted are expected to be outstanding and was calculated using the simplified method allowed by the SEC due to insufficient historical data. The estimated annual dividend was based on the recent dividend payout trend.

A benefit of \$1.1 million was recognized for the year ended December 31, 2011 as the overall decline in the fair value of the SPRs exceeded the amortization expense related to the unvested SPRs. Compensation expense of \$0.8 million was recorded for the year ended December 31, 2010 and no expense or benefit was incurred in 2009 as the decrease in the SPRs value was offset by the amortization expense. No cash has been paid out for SPR exercises during the three year period ended December 31, 2011.





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Activity related to the Company's SPRs during the year ended December 31, 2011 was as follows:

|                                  | September 30,<br>Number<br>of SPRs | September 30,<br>Weighted<br>Average<br>Exercise Price |
|----------------------------------|------------------------------------|--------------------------------------------------------|
| Outstanding on December 31, 2010 | 302,250                            | \$ 27.54                                               |
| Cancelled                        | (26,050)                           | 27.05                                                  |
| Outstanding on December 31, 2011 | 276,200                            | 27.58                                                  |
| Exercisable on December 31, 2011 | 246,834                            | \$ 28.78                                               |

The SPRs outstanding had an immaterial intrinsic value as of December 31, 2011. Unrecognized compensation cost related to non-vested SPRs was \$0.1 million at December 31, 2011, which will be recognized over a weighted average period of one year. During the year ended December 31, 2011, 56,333 SPRs with a fair value of \$0.3 million vested. At December 31, 2011, the weighted average remaining contractual term was 5.1 years for all outstanding SPRs and also for the all exercisable SPRs.

**Restricted Stock Awards**

Restricted stock awards vest ratably over a one to three year period beginning on the first anniversary of the date of the grant. On each vesting date the vested restricted stock awards are exchanged for an equal number of the Company's common stock. Common stock received by the participant cannot be transferred until either the end of the three year term or employment with the Company is terminated without cause. The participants have no voting or dividend rights with the restricted stock awards or the common shares received through vesting until the final vesting date unless they leave the Company without cause. The restricted stock awards are valued at the closing price of the common stock on the date of grant and the expense is recorded ratably over the vesting period.

Activity related to the Company's RSAs during the year ended December 31, 2011 was as follows:

|                                  | September 30,<br>Restricted Stock<br>Awards |
|----------------------------------|---------------------------------------------|
| Outstanding on December 31, 2010 | 59,765                                      |
| Granted                          | 52,149                                      |
| Exchanged for common shares      | (46,719)                                    |
| Cancelled                        | (1,805)                                     |
| Outstanding on December 31, 2011 | 63,390                                      |

An expense of \$0.7 million and \$0.5 million was recorded in Selling, general and administrative expenses in 2011 and 2010, respectively. As of December 31, 2011, there was \$0.6 million of total unrecognized compensation cost related to RSAs that will be recognized over a weighted average period of 1.2 years. The awards granted in 2011 had a weighted average grant date fair value of \$19.78 per share.

Restricted Stock Units

RSUs can be exchanged for either the Company's common stock or the equivalent value in cash on the vesting date. In April, 2010 the Company issued 30,944 RSUs which vested in April 2011. All of the vested RSUs were exchanged for cash in the amount of \$0.7 million. An expense of \$0.2 million and \$0.5 million was recorded in Selling, general and administrative expenses in 2011 and 2010, respectively. As of December 31, 2011, there were no outstanding RSUs.

***Performance based awards***

The Company has three Long-Term Incentive Plans. One plan was established for both the Company's Senior Executive Officers and the Company's Vice Presidents covering the 2011 to 2013 performance period ( 2011 LTIP ) and two plans covering the 2010 to 2012 performance period; one for the Senior Executive Officers ( 2010 SEO LTIP ) and one for the Company's Vice Presidents ( 2010 VP LTIP ). Awards under these plans are contingent on the level of financial performance of the Company over the performance period compared to pre-established targets. An expense of \$0.2 million and \$0.4 million for performance based awards for 2011 and 2010, respectively, was included in Selling, general and administrative expense.

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**Lawson Products, Inc.**

**Notes to Consolidated Financial Statements**

**2011 LTIP**

The performance based portion of the 2011 LTIP will be awarded in cash at the end of the three year period. The 2011 LTIP also includes an RSA component based on service only. These RSAs have been included in the Service Awards Based section above.

**2010 SEO LTIP**

Participants in the 2010 SEO LTIP can earn one-third of the total target award if the financial performance of the Company exceeds the established threshold levels for each year. At the end of the three-year performance period, the average actual results for the three years will be determined and the achievement calculated as a percent of the average annual goals for the entire performance period. The award for each fiscal year will then be adjusted based on the average annual results achieved. If a certain minimum performance level is not attained for the three year period, no award will be earned for any of the three years.

Under the terms of the 2010 SEO LTIP, at the end of the three year period, one half of the amount earned is payable in cash and one half is payable in the Company's common stock. The maximum amount of stock that could be issued, assuming the December 31, 2012 closing price of the stock remained at the December 31, 2011 closing price of \$15.43 would be 81,772 shares.

**2010 VP LTIP**

Participants in the 2010 VP LTIP can earn one-third of the total target award if the financial performance of the Company exceeds the established threshold levels for each year. The 2010 VP LTIP is payable one half in restricted stock and one half in non-qualified stock options. As of December 31, 2011, there were 13,112 shares of restricted stock and 27,661 non-qualified stock options with a weighted average exercise price of \$14.05 outstanding that represents the maximum amount that can be earned by the participants over the three year period. These amounts may be reduced based on the Company's financial performance over the upcoming years.

A portion of the total 2010 VP LTIP can be earned each year; 30% in 2010, 30% in 2011 and 40% in 2012. The awards are earned each year and vest at the end of the three year period. If certain minimum performance levels are not attained in any given year, no award will be earned that year.

**Note 14 Sale of Distribution Centers**

In 2010, the Company sold its Dallas, Texas distribution center receiving cash proceeds of \$2.0 million resulting in a gain of \$1.7 million. In 2009, the Company closed its Charlotte, North Carolina and Dallas, Texas distribution centers. The Company sold its Charlotte, North Carolina distribution center in 2009 receiving proceeds of \$2.2 million in cash.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 15 Other Operating Expenses (Income)**

Other Operating (Income) Expenses consisted of the following:

|                                 | September 30,<br>2011 | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|---------------------------------|-----------------------|----------------------------------------------------------------------------|-----------------------|
| Employment tax matter           | \$ 1,200              | \$                                                                         | \$                    |
| Impairment of long-lived assets | 1,146                 |                                                                            | 327                   |
| Share settlement                |                       | (4,050)                                                                    |                       |
| Other                           |                       |                                                                            | 154                   |
| Ending balance                  | \$ 2,346              | \$ (4,050)                                                                 | \$ 481                |

In 2011, the Company recorded a \$1.2 million expense for the estimated cost of settling an employment tax matter related to the classification of the sales representatives of one of the Company's subsidiaries. For further details, see Note 12 *Commitments and Contingencies*.

Also in 2011, an impairment charge of \$1.1 million was incurred related to certain assets in our OEM segment.

In 2010, the Company recorded a \$4.1 million benefit related to proceeds received from a settlement agreement and legal remedies related to the actions of several former sales representatives and the Share Corporation (Share) alleging, among other things, breach of contract and interference with customer relationships. In exchange for the proceeds, the Company agreed to settle all related claims with Share and the former sales representatives.

Other operating expenses in 2009 include \$0.2 million related to the investigation by the U.S. Attorney's Office for the Northern District of Illinois as to whether our sales representatives provided improper gifts or awards to purchasing agents through the Company's customer loyalty programs. Additionally, in 2009, an impairment charge of \$0.3 million was incurred to reduce the carrying value of certain property, plant and equipment to fair value.

**Note 16 Discontinued operations****Assembly Component Systems, Inc.**

In 2010, the Company sold substantially all of the assets of Assembly Component Systems, Inc. (ACS), a wholly owned subsidiary, to Supply Technologies LLC (Supply Technologies), a wholly owned company of Park-Ohio Holdings Corp. Under terms of the Asset Purchase Agreement, Supply Technologies purchased substantially all of the assets of ACS for \$19.0 million plus the assumption of certain liabilities. Of the total consideration, \$16.0 million was paid to Lawson in cash on September 1, 2010. The remaining balance was subject to the terms of a subordinated promissory note between Supply Technologies and Lawson. A \$3.5 million pre-tax loss on the sale was recorded in 2010. As of December 31, 2011, \$0.9 million of the note was still outstanding and is classified as current under Miscellaneous receivables and prepaid expenses.

**Rutland Tool & Supply Company, Inc.**

In 2010, the Company sold substantially all of the assets of Rutland Tool & Supply Company, Inc. to Sid Tool Co. Inc., a wholly owned subsidiary of MSC Industrial Direct Co., Inc., for approximately \$11.0 million in cash plus the assumption of certain liabilities. A \$0.4 million

pre-tax loss on the sale was recorded in 2010.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 17 Earnings (Loss) Per Share**

The computation of basic and diluted earnings (loss) per share consisted of the following:

|                                                           | September 30,<br>(Dollars in thousands, except per share data)<br>Year Ended December 31, |          |            |
|-----------------------------------------------------------|-------------------------------------------------------------------------------------------|----------|------------|
|                                                           | 2011                                                                                      | 2010     | 2009       |
| <b>Weighted average shares:</b>                           |                                                                                           |          |            |
| Basic weighted average shares outstanding                 | 8,553                                                                                     | 8,522    | 8,522      |
| Effect of dilutive securities outstanding                 |                                                                                           | 15       |            |
| Diluted weighted average shares outstanding               | 8,553                                                                                     | 8,537    | 8,522      |
| <b>Earnings (loss):</b>                                   |                                                                                           |          |            |
| Continuing operations                                     | \$ (4,389)                                                                                | \$ 9,590 | \$ 1,912   |
| Discontinued operations                                   | (235)                                                                                     | (2,653)  | (4,648)    |
| Net income (loss)                                         | \$ (4,624)                                                                                | \$ 6,937 | \$ (2,736) |
| <b>Basic earnings (loss) per share of common stock:</b>   |                                                                                           |          |            |
| Continuing operations                                     | \$ (0.51)                                                                                 | \$ 1.13  | \$ 0.22    |
| Discontinued operations                                   | (0.03)                                                                                    | (0.32)   | (0.54)     |
| Net income (loss)                                         | \$ (0.54)                                                                                 | \$ 0.81  | \$ (0.32)  |
| <b>Diluted earnings (loss) per share of common stock:</b> |                                                                                           |          |            |
| Continuing operations                                     | \$ (0.51)                                                                                 | \$ 1.12  | \$ 0.22    |
| Discontinued operations                                   | (0.03)                                                                                    | (0.31)   | (0.54)     |
| Net income (loss)                                         | \$ (0.54)                                                                                 | \$ 0.81  | \$ (0.32)  |

The effect of restricted share awards outstanding and future stock option exercises for the years ended December 31, 2011 and 2009 would have been anti-dilutive and therefore, were excluded from the computation of diluted earnings per share.

**Note 18 Related Party Transaction**

The Company's Chairman of the Board, Dr. Port, was a partner in two partnerships that had an interest in Lawson's common stock. During 2010, litigation was initiated against Dr. Port, requesting that the partnerships be changed to allow the partners to have more control over their respective shares. The suit named Dr. Port as a defendant based on his role in the partnerships and as a Director of the Company. The Company was not a party to the lawsuit.

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In March, 2011 the litigation was settled with assets distributed under the terms of a settlement agreement and all parties agreed to release Dr. Port, individually and as a Director of the Company, from any and all claims related to the litigation. In 2011 and 2010 the Company incurred \$0.1 million and \$0.7 million, respectively, for legal services provided to Dr. Port in relation to this litigation.



**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 19 Segment Reporting**

The Company has two operating segments: MRO and OEM. The Company's MRO segment is a distributor of products and services to the industrial, commercial, institutional, and governmental maintenance repair and operations marketplace. The Company's OEM segment manufactures, sells and distributes production and specialized component parts to the original equipment marketplace. The Company's two reportable segments are distinguished by the nature of products distributed and sold, types of customers and manner of servicing them. The Company evaluates performance and allocates resources to reportable segments primarily based on operating income. The accounting policies of the segments are the same as those described in Note 2 *Significant Accounting Policies*.

Financial information for the Company's reportable segments from continuing operations consisted of the following:

|                                                              | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2011                      2010                      2009 |            |            |
|--------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Net sales                                                    |                                                                                                                                |            |            |
| MRO                                                          | \$ 300,399                                                                                                                     | \$ 303,138 | \$ 289,715 |
| OEM                                                          | 14,560                                                                                                                         | 13,642     | 12,054     |
| Consolidated total                                           | \$ 314,959                                                                                                                     | \$ 316,780 | \$ 301,769 |
| Operating income (loss)                                      |                                                                                                                                |            |            |
| MRO                                                          | \$ (2,466)                                                                                                                     | \$ 14,522  | \$ 9,256   |
| OEM                                                          | 952                                                                                                                            | 283        | (1,118)    |
| Severance expenses                                           | (1,614)                                                                                                                        | (3,629)    | (6,228)    |
| Gain (loss) on sale of assets                                | (22)                                                                                                                           | 1,701      | (16)       |
| Other operating income (expense)                             | (2,346)                                                                                                                        | 4,050      | (481)      |
| Consolidated total                                           | (5,496)                                                                                                                        | 16,927     | 1,413      |
| Interest expense                                             | (681)                                                                                                                          | (391)      | (1,037)    |
| Other income, net                                            | 101                                                                                                                            | 160        | 1,029      |
| Income (loss) from continuing operations before income taxes | \$ (6,076)                                                                                                                     | \$ 16,696  | \$ 1,405   |
| Capital expenditures                                         |                                                                                                                                |            |            |
| MRO                                                          | \$ 11,066                                                                                                                      | \$ 10,038  | \$ 2,008   |
| OEM                                                          | 66                                                                                                                             | 10         | 713        |
| Consolidated total                                           | \$ 11,132                                                                                                                      | \$ 10,048  | \$ 2,721   |
| Depreciation and amortization                                |                                                                                                                                |            |            |
| MRO                                                          | \$ 5,342                                                                                                                       | \$ 5,900   | \$ 6,031   |
| OEM                                                          | 362                                                                                                                            | 406        | 476        |

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|                    |    |       |    |       |    |       |
|--------------------|----|-------|----|-------|----|-------|
| Consolidated total | \$ | 5,704 | \$ | 6,306 | \$ | 6,507 |
|--------------------|----|-------|----|-------|----|-------|

|                         |    |         |    |         |    |         |
|-------------------------|----|---------|----|---------|----|---------|
| Total assets            |    |         |    |         |    |         |
| MRO                     | \$ | 194,422 | \$ | 210,273 | \$ | 167,394 |
| OEM                     |    | 10,336  |    | 9,749   |    | 12,428  |
|                         |    |         |    |         |    |         |
| Segment total           |    | 204,758 |    | 220,022 |    | 179,822 |
| Corporate               |    | 17,580  |    | 15,743  |    | 20,068  |
| Discontinued operations |    | 410     |    | 619     |    | 41,757  |
|                         |    |         |    |         |    |         |
| Consolidated total      | \$ | 222,748 | \$ | 236,384 | \$ | 241,647 |

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**Lawson Products, Inc.**

**Notes to Consolidated Financial Statements**

Financial information related to the Company's continuing operations by geographic area consisted of the following:

|                    | September 30,<br>2011 | September 30,<br>(Dollars in thousands)<br>Year Ended December 31,<br>2010 | September 30,<br>2009 |
|--------------------|-----------------------|----------------------------------------------------------------------------|-----------------------|
| Net sales          |                       |                                                                            |                       |
| United States      | \$ 285,071            | \$ 288,054                                                                 | \$ 276,116            |
| Canada             | 29,888                | 28,726                                                                     | 25,653                |
| Consolidated total | \$ 314,959            | \$ 316,780                                                                 | \$ 301,769            |
| Long-lived assets  |                       |                                                                            |                       |
| United States      | \$ 49,353             | \$ 41,006                                                                  | \$ 36,911             |
| Canada             | 3,349                 | 3,436                                                                      | 3,417                 |
| Consolidated total | \$ 52,702             | \$ 44,442                                                                  | \$ 40,328             |

Net sales are attributed to countries based on the location of customers. Long-lived assets consist of property, plant and equipment.

**Table of Contents****Lawson Products, Inc.****Notes to Consolidated Financial Statements****Note 20 Summary of Unaudited Quarterly Results of Operations**

Unaudited quarterly results of operations for the years ended December 31, 2011 and 2010 are summarized as follows:

|                                                  | September 30,<br>Dec. 31 | September 30,<br>2011 Quarter Ended<br>Sep. 30 | September 30,<br>June 30 | September 30,<br>Mar. 31 |
|--------------------------------------------------|--------------------------|------------------------------------------------|--------------------------|--------------------------|
| (Dollars in thousands, except per share data)    |                          |                                                |                          |                          |
| Net sales                                        | \$ 72,860                | \$ 75,366                                      | \$ 84,154                | \$ 82,579                |
| Gross profit                                     | 38,993                   | 42,546                                         | 48,299                   | 49,939                   |
| Income (loss) from continuing operations (1)     | \$ (5,373)               | \$ (2,154)                                     | \$ 1,088                 | \$ 2,050                 |
| Loss from discontinued operations                | (174)                    | (9)                                            | (22)                     | (30)                     |
| Net income (loss)                                | \$ (5,547)               | \$ (2,163)                                     | \$ 1,066                 | \$ 2,020                 |
| Basic income (loss) per share of common stock:   |                          |                                                |                          |                          |
| Continuing operations (2)                        | \$ (0.63)                | \$ (0.25)                                      | \$ 0.13                  | \$ 0.24                  |
| Discontinued operations (2)                      | (0.02)                   |                                                | (0.01)                   |                          |
| Net income (loss) (2)                            | \$ (0.65)                | \$ (0.25)                                      | \$ 0.12                  | \$ 0.24                  |
| Diluted income (loss) per share of common stock: |                          |                                                |                          |                          |
| Continuing operations (2)                        | \$ (0.63)                | \$ (0.25)                                      | \$ 0.13                  | \$ 0.24                  |
| Discontinued operations (2)                      | (0.02)                   |                                                | (0.01)                   | (0.01)                   |
| Net income (loss) (2)                            | \$ (0.65)                | \$ (0.25)                                      | \$ 0.12                  | \$ 0.23                  |

|                                            | September 30,<br>Dec. 31 | September 30,<br>2010 Quarter Ended<br>Sep. 30 | September 30,<br>June 30 | September 30,<br>Mar. 31 |
|--------------------------------------------|--------------------------|------------------------------------------------|--------------------------|--------------------------|
| Net sales                                  | \$ 80,012                | \$ 81,553                                      | \$ 80,305                | \$ 74,910                |
| Gross profit                               | 49,764                   | 49,948                                         | 48,789                   | 46,325                   |
| Income from continuing operations (3)      | \$ 112                   | \$ 5,766                                       | \$ 1,480                 | \$ 2,232                 |
| Income (loss) from discontinued operations | (623)                    | (2,337)                                        | 207                      | 100                      |
| Net Income (loss)                          | \$ (511)                 | \$ 3,429                                       | \$ 1,687                 | \$ 2,332                 |

Basic and diluted income (loss) per share of common stock:

|                           |         |         |         |         |
|---------------------------|---------|---------|---------|---------|
| Continuing operations (2) | \$ 0.01 | \$ 0.68 | \$ 0.17 | \$ 0.26 |
|---------------------------|---------|---------|---------|---------|

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|                             |    |        |    |        |    |      |    |      |
|-----------------------------|----|--------|----|--------|----|------|----|------|
| Discontinued operations (2) |    | (0.07) |    | (0.28) |    | 0.03 |    | 0.01 |
| Net Income (loss)           | \$ | (0.06) | \$ | 0.40   | \$ | 0.20 | \$ | 0.27 |

- (1) Loss from continuing operations for the three months ended December 31, 2011 includes an \$0.8 million net expense for the estimated cost of settling an employment tax matter and a net \$0.8 million asset impairment charge.
- (2) The sum of the quarterly earnings per share amounts may not equal the total annual earnings per share due to rounding and the uneven timing of earnings throughout the year compared to the weighted average shares outstanding.
- (3) Income from continuing operations for the three months ended September 31, 2010 and March 31, 2010, respectively, includes a net benefit of \$2.1 million and \$0.3 million related to the Share litigation. Income from continuing operations for the three months ended March 31, 2010 includes a net gain of \$1.0 million from the sale of the Dallas, Texas distribution center.

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## SCHEDULE Valuation and Qualifying Accounts

## Lawson Products, Inc.

## Schedule II Valuation and Qualifying Accounts

The roll forward of valuation accounts were as follows:

| Description                                         | September 30,<br>Balance at<br>Beginning of<br>Period | September 30,<br>(Dollars in thousands)<br>Charged to<br>Costs and<br>Expenses | September 30,<br>(Dollars in thousands)<br>Deductions | September 30,<br>Balance at<br>End of<br>Period |
|-----------------------------------------------------|-------------------------------------------------------|--------------------------------------------------------------------------------|-------------------------------------------------------|-------------------------------------------------|
| <b>Allowance for doubtful accounts:</b>             |                                                       |                                                                                |                                                       |                                                 |
| Year ended December 31, 2011                        | \$ 1,085                                              | \$ 1,500                                                                       | \$ (673) (1)                                          | \$ 1,912                                        |
| Year ended December 31, 2010                        | 882                                                   | 883                                                                            | (680) (1)                                             | 1,085                                           |
| Year ended December 31, 2009                        | 871                                                   | 1,222                                                                          | (1,211) (1)                                           | 882                                             |
| <b>Allowance for excess and obsolete inventory:</b> |                                                       |                                                                                |                                                       |                                                 |
| Year ended December 31, 2011                        | \$ 4,711                                              | \$ 1,103                                                                       | \$ (768) (2)                                          | \$ 5,046                                        |
| Year ended December 31, 2010                        | 4,748                                                 | 110                                                                            | (147) (2)                                             | 4,711                                           |
| Year ended December 31, 2009                        | 4,778                                                 | 319                                                                            | (349) (2)                                             | 4,748                                           |
| <b>Valuation allowance for deferred tax assets:</b> |                                                       |                                                                                |                                                       |                                                 |
| Year ended December 31, 2011                        | \$ 875                                                | \$ 63                                                                          | \$                                                    | \$ 938                                          |
| Year ended December 31, 2010                        | 1,744                                                 |                                                                                | (869) (3)                                             | 875                                             |
| Year ended December 31, 2009                        | 2,854                                                 | (536)                                                                          | (574) (3)                                             | 1,744                                           |

(1) Uncollected receivables written off, net of recoveries and translation adjustment.

(2) Disposal of excess and obsolete inventory and translation adjustment.

(3) Capital loss carryforward written off.

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### **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

### **ITEM 9A. CONTROLS AND PROCEDURES.**

#### **Evaluation of Disclosure 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 annual 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.

#### **Management's Report on Internal Control over Financial Reporting**

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended, for Lawson Products, Inc. and subsidiaries (the Company). This system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements and even when determined to be effective, can only provide reasonable assurance with respect to financial statement preparation and presentation. Also, projection of any evaluation of the effectiveness of internal control over financial reporting to future periods is subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control - Integrated Framework*. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2011. The Company's independent registered public accounting firm, Ernst & Young LLP, has audited and issued a report on the Company's internal controls over financial reporting as set forth in this annual report.

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### **Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting**

To the Stockholders and Board of Directors

Lawson Products, Inc.

We have audited Lawson Products, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2011 based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO" criteria). Lawson Products, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, Lawson Products, Inc. maintained in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Lawson Products, Inc. as of December 31, 2011 and 2010 and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 and our report dated March 1, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Chicago, Illinois

March 1, 2012



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### **Changes in Internal Controls**

There were no changes in our internal control over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Other Matters**

In August 2011, we completed a major phase of the implementation of a new ERP system. The ERP implementation replaced our existing order entry, fulfillment, service and financial systems, resulting in significant changes to our business processes and therefore our internal controls. These changes are intended to improve customer service and controls and reduce manual processes. Our implementation process was designed to identify and remediate control issues as they are identified. We have monitoring controls in place to ensure the ongoing reliability of our financial reporting. We believe the controls, as implemented, are appropriate and functioning effectively.

### **ITEM 9B. OTHER INFORMATION.**

None.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

#### **a. Directors**

The information required by this Item is set forth in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012, under the caption "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance," which information is incorporated herein by reference.

#### **b. Executive Officers**

The information required by this Item is set forth under the caption Item 1 "Business" under "Executive Officers of the Registrant."

#### **c. Audit Committee**

Information on the Company's Audit Committee is contained under the caption "Board of Directors Meetings and Committees" in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012, which is incorporated herein by reference.

The Board of Directors has determined that Thomas Postek, member of the Audit Committee of the Board of Directors, qualifies as an "audit committee financial expert" as defined in Item 407(d)(5)(ii) of Regulation S-K, and that Mr. Postek is "independent" as the term is defined in the listing standards of the NASDAQ Global Select Market.

#### **d. Code of Business Conduct**

The Company has adopted a Code of Business Conduct applicable to all employees and sales representatives. The Company's Code of Business Conduct is applicable to senior financial executives including the principal executive officer, principal financial officer and principal accounting officer of the Company. The Company's Code of Business Conduct is available on the Corporate Governance page in the Investor Relations section of the Company's website at [www.lawsonproducts.com](http://www.lawsonproducts.com). The Company intends to post on its website any amendments to, or waivers from its Code of Business Conduct applicable to senior financial executives. The Company will provide any persons with a copy of its Code of Business Conduct without charge upon written request directed to the Company's Secretary at the Company's address.



**Table of Contents****ITEM 11. EXECUTIVE COMPENSATION.**

The information required by this Item is set forth in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012, under the caption "Remuneration of Executive Officers," which information is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information required by this Item is set forth in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012 under the caption "Securities Beneficially Owned by Principal Stockholders and Management" which information is incorporated herein by reference.

**Equity Compensation Plan Information**

The following table provides information as of December 31, 2011 regarding the number of shares of common stock that were available for issuance under the Company's equity compensation plans.

| Plan category                                              | September 30,<br>Number of securities<br>to be issued upon<br>exercise of<br>outstanding<br>options,<br>warrants and<br>rights | September 30,<br>Weighted-average<br>exercise price of<br>outstanding<br>options,<br>warrants<br>and rights | September 30,<br>Number of securities<br>remaining available for future<br>issuance under equity<br>compensation plans<br>(excluding securities<br>reflected<br>in the first column) |
|------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 185,929 (1)                                                                                                                    | \$ 14.05 (2)                                                                                                | 261,781                                                                                                                                                                              |
| Equity compensation plans not approved by security holders |                                                                                                                                |                                                                                                             |                                                                                                                                                                                      |
| Total                                                      | 185,929 (1)                                                                                                                    | \$ 14.05 (2)                                                                                                | 261,781                                                                                                                                                                              |

(1) Includes common stock to cover conversion of 158,460 restricted stock awards and 27,661 stock options.

(2) Weighted-average exercise price of 27,661 stock options outstanding on December 31, 2011.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information required by this Item is set forth in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012 under the caption "Election of Directors" and "Certain Relationships and Related Transactions" which information is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The information required under this Item is set forth in the Company's Proxy Statement for the Annual Meeting of Stockholders to be held on May 15, 2012 under the caption "Fees Paid to Independent Auditors" which information is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

- (a) (1) See Index to Financial Statements in Item 8 on page 29.
- (2) See Schedule II in Item 8 on page 53.
- (3) See the Exhibit Index immediately following the signature page of this Annual Report on Form 10-K.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

By: /s/ Thomas J. Neri  
Thomas J. Neri  
President, Chief Executive Officer and Director  
  
(principal executive officer)

Date: March 1, 2012

By: /s/ Ronald J. Knutson  
Ronald J. Knutson  
Senior Vice President, Chief Financial Officer  
  
(principal financial and accounting officer)

Date: March 1, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below this first day of March, 2012, by the following persons on behalf of the registrant and in the capacities indicated.

| <b>Signature</b>                           | <b>Title</b>                                                                     |
|--------------------------------------------|----------------------------------------------------------------------------------|
| /s/ Thomas J. Neri<br>Thomas J. Neri       | President, Chief Executive Officer and Director<br>(principal executive officer) |
| /s/ Ronald B. Port<br>Ronald B. Port       | Chairman of the Board                                                            |
| /s/ Andrew B. Albert<br>Andrew B. Albert   | Director                                                                         |
| /s/ I. Steven Edelson<br>I. Steven Edelson | Director                                                                         |
| /s/ James S. Errant<br>James S. Errant     | Director                                                                         |
| /s/ Lee S. Hillman<br>Lee S. Hillman       | Director                                                                         |

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/s/ Thomas S. Postek  
Thomas S. Postek

Director

/s/ Robert G. Rettig  
Robert G. Rettig

Director

/s/ Wilma J. Smelcer  
Wilma J. Smelcer

Director

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**EXHIBIT INDEX**

**Exhibit**

| <b>Number</b> | <b>Description of Exhibit</b>                                                                                                                                                                                                                                                                         |
|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1           | Asset Purchase Agreement By and Among Assembly Component Systems, Inc., Lawson Products, Inc., Supply Technologies LLC and Park-Ohio Industries, Inc. dated as of August 31, 2010, incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated August 31, 2010. |
| 2.2           | Asset Purchase Agreement By and Among Rutland Tool & Supply Co., Lawson Products, Inc., Sid Tool Co., Inc. and MSC Industrial Direct Co., Inc. dated as of November 9, 2010, incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K dated November 9, 2010.      |
| 3.1           | Certificate of Incorporation of the Company, as amended, incorporated herein by reference to Exhibit 3(a) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1988.                                                                                                    |
| 3.2           | Amended and Restated By-laws of the Company, incorporated herein by reference to the Company's Current Report on Form 8-K dated October 20, 2009.                                                                                                                                                     |
| 10.1*         | Amended and Restated Executive Deferral Plan, incorporated herein by reference from Exhibit 10(c)(7) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.                                                                                                         |
| 10.2*         | Lawson Products, Inc. Stock Performance Plan, incorporated herein by reference from Exhibit 10(c)(8) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.                                                                                                         |
| 10.3*         | Lawson Products, Inc. Long-Term Capital Accumulation Plan, incorporated herein by reference to Exhibit 10(c)(10) to the Company's Current Report on Form 8-K dated October 21, 2004.                                                                                                                  |
| 10.4*         | Form of Shareholder Value Appreciation Rights Award Agreement, incorporated by reference to Exhibit 10(c)(14) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.                                                                                                |
| 10.5*         | Form Letter regarding Stock Performance Rights, incorporated by reference to Exhibit 10(c)(16) to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.                                                                                                               |
| 10.6*         | Executive Employment Agreement dated December 5, 2005 between the Company and Stewart Howley, incorporated herein by reference to Exhibit 10.11 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.                                                              |
| 10.7*         | Employment Agreement dated February 29, 2008 between the Company and Harry Dochelli, incorporated herein by reference to Exhibit 10.12 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.                                                                       |
| 10.8*         | Lawson Products, Inc. Long-Term Incentive Plan, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 13, 2008.                                                                                                                                      |
| 10.9          | Deferred Prosecution Agreement, dated August 11, 2008 between the Company and the United States District Court, Northern District of Illinois Eastern Division, incorporated by reference to Exhibit 10.1 to the Company's Form 10-Q for the quarter ended June 30, 2008.                             |

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**Exhibit**

| <b>Number</b> | <b>Description of Exhibit</b>                                                                                                                                                                                                                                                                                                                                                                                          |
|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.10*        | Form of Indemnification Agreement for Directors and Officers incorporated herein by reference to the Company's Current Report on Form 8-K dated September 15, 2008.                                                                                                                                                                                                                                                    |
| 10.11         | Amendment No. 1 to Lawson Products, Inc. Long-Term Capital Accumulation Plan, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                                                           |
| 10.12*        | Form of Amended and Restated Award Agreement, incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                                                                                           |
| 10.13*        | Amended and Restated Employment Agreement dated as of February 12, 2009 by and between the Company and Thomas Neri, incorporated by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                     |
| 10.14*        | Amended and Restated Employment Agreement dated as of February 12, 2009 by and between the Company and Neil E. Jenkins, incorporated by reference to Exhibit 10.4 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                 |
| 10.15*        | Change in Control Agreement dated as of February 12, 2009 by and between the Company and Harry Dochelli, incorporated by reference to Exhibit 10.5 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                                |
| 10.16*        | Change in Control Agreement dated as of February 12, 2009 by and between the Company and Stewart Howley, incorporated by reference to Exhibit 10.6 to the Company's Current Report on Form 8-K dated February 12, 2009.                                                                                                                                                                                                |
| 10.17         | Amendment No. 1 to Deferred Prosecution Agreement dated July 31, 2009, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated July 31, 2009.                                                                                                                                                                                                                                      |
| 10.18         | Credit Agreement dated as of August 21, 2009, by and among Lawson Products, Inc. and certain of its subsidiaries and The PrivateBank and Trust Company, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated August 21, 2009 and with all exhibits and schedules, incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated January 29, 2010. |
| 10.19         | Consent, Waiver and First Amendment to the Credit Agreement dated December 31, 2009 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated December 31, 2009.                                                                                                                                                   |
| 10.20*        | Change in Control Agreement dated January 29, 2010 between the Company and Mr. Ronald Knutson, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated January 29, 2010.                                                                                                                                                                                                    |
| 10.21*        | Second Amendment to the Credit Agreement dated January 29, 2010 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated January 29, 2010.                                                                                                                                                                        |
| 10.22         | Consent, Waiver and Third Amendment to the Credit Agreement dated September 1, 2010 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated August 31, 2010.                                                                                                                                                     |
| 10.23         | Consent, Waiver and Fourth Amendment to the Credit Agreement dated December 10, 2010 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated December 10, 2010.                                                                                                                                                  |



## **Table of Contents**

### **Exhibit**

| <b>Number</b> | <b>Description of Exhibit</b>                                                                                                                                                                                                                      |
|---------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.24         | Fifth Amendment to the Credit Agreement dated September 30, 2011 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated September 30, 2011. |
| 10.25         | Sixth Amendment to the Credit Agreement dated December 29, 2011 between the Company and The PrivateBank and Trust Company, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated December 29, 2011.   |
| 21            | Subsidiaries of the Company.                                                                                                                                                                                                                       |
| 23            | Consent of Ernst & Young LLP.                                                                                                                                                                                                                      |
| 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 906 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.LAB **    | XBRL Taxonomy Extension Label Linkbase Document                                                                                                                                                                                                    |
| 101.PRE **    | XBRL Taxonomy Extension Presentation Linkbase Document                                                                                                                                                                                             |

\* Indicates management employment contracts or compensatory plans or arrangements.

\*\* Furnished but not filed