

LAWSON PRODUCTS INC/NEW/DE/

Form 10-Q

July 28, 2011

Table of Contents

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

(Mark One)

Quarterly Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934

For quarterly period ended June 30, 2011

or

Transition Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file Number: 0-10546

LAWSON PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware

36-2229304

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

1666 East Touhy Avenue, Des Plaines, Illinois

60018

(Address of principal executive offices)

(Zip Code)

(847) 827-9666

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller
reporting company)

Smaller reporting
company

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

The number of shares outstanding of the registrant's common stock, \$1 par value, as of July 15, 2011 was 8,565,517.

Table of Contents

Safe Harbor Statement under the Securities Litigation Reform Act of 1995:

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. The terms may, should, could, anticipate, believe, continues, estimate, expect, intend, objective, plan, potential, project and similar are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. These statements are based on management's current expectations, intentions or beliefs and are subject to a number of factors, assumptions and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include:

- the effect of general economic and market conditions;
- inventory obsolescence;
- work stoppages and other disruptions at transportation centers or shipping ports;
- changing customer demand and product mixes;
- increases in commodity prices;
- disruptions of the Company's information and communication systems;
- the inability of management to successfully implement strategic initiatives;
- failure to manage change;
- failure to retain a talented workforce;
- the influence of controlling stockholder;
- changes in taxation; and,

all other factors discussed in the Company's Risk Factors set forth in its Annual Report on Form 10-K for the year ended December 31, 2010 and in this Quarterly Report on Form 10-Q.

The Company undertakes no obligation to update any such factors or to publicly announce the results of any revisions to any forward-looking statements contained herein whether as a result of new information, future events or otherwise.

TABLE OF CONTENTS

| | Page # |
|--|--------|
| <u>PART I FINANCIAL INFORMATION</u> | |
| <u>Item 1 Financial Statements</u> | |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2011 (Unaudited) and December 31, 2010</u> | 4 |
| <u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010 (Unaudited)</u> | 5 |
| <u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2011 and 2010 (Unaudited)</u> | 6 |
| <u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u> | 7 |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 10 |
| <u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u> | 15 |
| <u>Item 4 Controls and Procedures</u> | 15 |
| <u>PART II OTHER INFORMATION</u> | |
| <u>Item 1A Risk Factors</u> | 15 |
| <u>Item 6 Exhibits Index</u> | 16 |
| <u>SIGNATURES</u> | |
| <u>Exhibit 31.1</u> | |
| <u>Exhibit 31.2</u> | |
| <u>Exhibit 32</u> | |
| <u>EX-101 INSTANCE DOCUMENT</u> | |
| <u>EX-101 SCHEMA DOCUMENT</u> | |
| <u>EX-101 CALCULATION LINKBASE DOCUMENT</u> | |
| <u>EX-101 LABELS LINKBASE DOCUMENT</u> | |
| <u>EX-101 PRESENTATION LINKBASE DOCUMENT</u> | |

Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS**

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

| | June 30, 2011 (unaudited) | December 31, 2010 |
|---|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 22,734 | \$ 40,566 |
| Accounts receivable, less allowance for doubtful accounts | 37,313 | 33,398 |
| Inventories | 50,494 | 47,167 |
| Miscellaneous receivables and prepaid expenses | 6,750 | 8,905 |
| Deferred income taxes | 4,340 | 4,251 |
| Discontinued operations | 653 | 619 |
| Total current assets | 122,284 | 134,906 |
| Property, plant and equipment, net | 49,578 | 44,442 |
| Cash value of life insurance | 16,112 | 15,660 |
| Deferred income taxes | 10,075 | 11,492 |
| Goodwill | 28,550 | 28,307 |
| Other assets | 1,015 | 1,577 |
| Total assets | \$ 227,614 | \$ 236,384 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 18,006 | \$ 18,195 |
| Accrued expenses and other liabilities | 26,390 | 35,348 |
| Discontinued operations | 590 | 2,008 |
| Total current liabilities | 44,986 | 55,551 |
| Security bonus plan | 25,109 | 25,602 |
| Deferred compensation | 10,923 | 10,792 |
| Other liabilities | 1,655 | 1,574 |
| | 37,687 | 37,968 |

Stockholders equity:

| | | |
|---|------------|------------|
| Preferred stock, \$1 par value: | | |
| Authorized 500,000 shares, Issued and outstanding | None | |
| Common stock, \$1 par value: | | |
| Authorized 35,000,000 shares | | |
| Issued 8,568,220 and 8,534,028 shares | | |
| Outstanding 8,565,517 and 8,531,325 shares | 8,568 | 8,534 |
| Capital in excess of par value | 5,925 | 5,328 |
| Retained earnings | 127,135 | 126,098 |
| Treasury stock 2,703 shares | (70) | (70) |
| Accumulated other comprehensive income | 3,383 | 2,975 |
| Stockholders equity | 144,941 | 142,865 |
| Total liabilities and stockholders equity | \$ 227,614 | \$ 236,384 |

See notes to condensed consolidated financial statements.

Table of Contents

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|------------|
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | \$ 84,154 | \$ 80,305 | \$ 166,733 | \$ 155,215 |
| Cost of goods sold | 35,855 | 31,516 | 68,495 | 60,101 |
| Gross profit | 48,299 | 48,789 | 98,238 | 95,114 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 46,242 | 44,773 | 91,691 | 88,492 |
| Severance expense | 465 | 1,224 | 1,210 | 1,650 |
| Gain on sale of assets | | | | (1,701) |
| Legal settlement | | | | (550) |
| Operating income | 1,592 | 2,792 | 5,337 | 7,223 |
| Other income | 63 | 23 | 79 | 39 |
| Interest expense | (71) | (196) | (583) | (281) |
| Income from continuing operations before income taxes | 1,584 | 2,619 | 4,833 | 6,981 |
| Income tax expense | 496 | 1,139 | 1,695 | 3,269 |
| Income from continuing operations | 1,088 | 1,480 | 3,138 | 3,712 |
| Discontinued operations, net of income taxes | (22) | 207 | (52) | 307 |
| Net income | \$ 1,066 | \$ 1,687 | \$ 3,086 | \$ 4,019 |
| Basic income per share of common stock: | | | | |
| Continuing operations | \$ 0.13 | \$ 0.17 | \$ 0.37 | \$ 0.44 |
| Discontinued operations | (0.01) | 0.03 | (0.01) | 0.03 |
| Net income per share | \$ 0.12 | \$ 0.20 | \$ 0.36 | \$ 0.47 |
| Diluted income per share of common stock: | | | | |
| Continuing operations | \$ 0.13 | \$ 0.17 | \$ 0.36 | \$ 0.44 |

Edgar Filing: LAWSON PRODUCTS INC/NEW/DE/ - Form 10-Q

| | | | | |
|---|---------|---------|---------|---------|
| Discontinued operations | (0.01) | 0.03 | (0.00) | 0.03 |
| Net income per share | \$ 0.12 | \$ 0.20 | \$ 0.36 | \$ 0.47 |
| Basic weighted average shares outstanding | 8,550 | 8,522 | 8,541 | 8,522 |
| Dilutive effect of stock based compensation | 60 | 7 | 67 | 4 |
| Diluted weighted average shares outstanding | 8,610 | 8,529 | 8,608 | 8,526 |
| Cash dividends declared per share of common stock | \$ 0.12 | \$ 0.06 | \$ 0.24 | \$ 0.12 |

See notes to condensed consolidated financial statements.

Table of Contents

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

| | Six Months Ended June 30, | |
|---|---------------------------|-------------------|
| | 2011 | 2010 |
| Operating activities: | | |
| Net income | \$ 3,086 | \$ 4,019 |
| Loss (income) from discontinued operations | 52 | (307) |
| Income from continuing operations | 3,138 | 3,712 |
| Adjustments to reconcile to net cash used in operating activities: | | |
| Depreciation and amortization | 2,721 | 2,953 |
| Deferred income taxes | 1,328 | 4,813 |
| Stock based compensation | 132 | 158 |
| Gain on sale of property | | (1,701) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (3,968) | (5,144) |
| Inventories | (3,181) | (5,086) |
| Prepaid expenses and other assets | 1,731 | (2,154) |
| Accounts payable and accrued expenses | (7,977) | (338) |
| Other | (1,030) | (1,743) |
| Net cash used in operating activities of continuing operations | \$ (7,106) | \$ (4,530) |
| Investing activities: | | |
| Additions to property, plant and equipment | \$ (7,677) | \$ (3,615) |
| Net outlay related to sale of businesses | (442) | |
| Proceeds from sale of property | | 2,027 |
| Net cash used in investing activities of continuing operations | \$ (8,119) | \$ (1,588) |
| Financing activities: | | |
| Dividends paid | \$ (2,045) | \$ (1,534) |
| Net proceeds from line of credit | | 5,150 |
| Other | | (32) |
| Net cash (used in) provided by financing activities of continuing operations | \$ (2,045) | \$ 3,584 |
| Discontinued operations: | | |
| Operating cash flows | \$ (562) | \$ 2,367 |

| | | | |
|---|----|----------|----------|
| Investing cash flows | | | (4) |
| Net cash (used in) provided by activities of discontinued operations | \$ | (562) | \$ 2,363 |
| Decrease in cash and cash equivalents | | (17,832) | (171) |
| Cash and cash equivalents at beginning of period | | 40,566 | 8,787 |
| Cash and cash equivalents at end of period | \$ | 22,734 | \$ 8,616 |

See notes to condensed consolidated financial statements.

Table of Contents

Lawson Products, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 Basis of Presentation and Summary of Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements of Lawson Products, Inc. (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all disclosures required by generally accepted accounting principles. Reference should be made to the Company's Annual Report on Form 10-K for the year ended December 31, 2010. In the opinion of the Company, all normal recurring adjustments have been made, that are necessary to present fairly the results of operations for the interim periods. Operating results for the three and six month periods ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

The condensed consolidated financial statements have been reclassified for all prior periods presented to reflect current discontinued operations treatment (see Note 2 *Discontinued Operations*). Unless noted otherwise, discussions in the Notes to Condensed Consolidated Financial Statements pertain to continuing operations. Certain other reclassifications have been made to prior period amounts to conform to current period presentation. Such reclassifications have no effect on net income as previously reported.

There have been no material changes in our significant accounting policies during the six months ended June 30, 2011 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2010. The Company has determined that there were no subsequent events to recognize or disclose in these financial statements.

Note 2 Discontinued operations

In December 2010, the Company sold substantially all of the assets of Rutland Tool & Supply Company, Inc. (Rutland). Accordingly, Rutland's results of operations have been reflected in discontinued operations. Rutland's net sales, which were previously included in the Company's Maintenance Repair and Operations (MRO) segment, were \$7.9 million and \$15.6 million for the three and six month periods ended June 30, 2010, respectively.

In August 2010, the Company sold substantially all of the assets of Assembly Component Systems, Inc. (ACS) and as a result, ACS's results of operations have been reflected in discontinued operations. ACS's net sales, which were previously included in the Company's Original Equipment Marketplace (OEM) segment, were \$13.4 million and \$25.9 million for the three and six month periods ended June 30, 2010, respectively.

Note 3 Inventories

Components of inventories were as follows:

| | (Amounts in thousands) | |
|---|------------------------|----------------------|
| | June 30, 2011 | December 31, 2010 |
| Finished goods | \$ 51,827 | \$ 49,084 |
| Work in progress | 1,475 | 1,203 |
| Raw materials | 1,650 | 1,591 |
| Total | 54,952 | 51,878 |
| Reserve for obsolete and excess inventory | (4,458) | (4,711) |
| | \$ 50,494 | \$ 47,167 |

Table of Contents

Lawson Products, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 4 Severance Reserve

The table below shows the changes in the Company's reserve for severance and related payments, included in accrued expenses and other liabilities on the Condensed Consolidated Balance Sheets as of June 30, 2011 and 2010:

| | (Amounts in thousands) | |
|------------------------------|---------------------------|----------|
| | Six Months Ended June 30, | |
| | 2011 | 2010 |
| Balance at beginning of year | \$ 3,062 | \$ 4,086 |
| Charged to earnings | 1,210 | 1,650 |
| Cash paid | (2,062) | (2,582) |
| Balance at end of the period | \$ 2,210 | \$ 3,154 |

Note 5 Gain on Sale of Assets

In the first six months of 2010, the Company received cash proceeds of \$2.0 million from the sale of its Dallas, Texas distribution center, resulting in a gain of \$1.7 million.

Note 6 Legal Settlement

During the six month period ended June 30, 2010, the Company recorded a \$0.6 million benefit related to proceeds received from legal remedies related to the actions of several former sales agents and Share Corporation alleging, among other things, breach of contract and interference with customer relationships.

Note 7 Income Tax

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 June 30, 2011, the Company is subject to U.S. Federal income tax examinations for the year 2009 and income tax examinations from various other jurisdictions for the years 2005 through 2010.

Note 8 Comprehensive Income

Components of comprehensive income for the three and six months ended June 30, 2011 and 2010 are as follows:

| | (Amounts in thousands) | | | |
|---|------------------------|----------|------------------|----------|
| | Three Months Ended | | Six Months Ended | |
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net income | \$ 1,066 | \$ 1,687 | \$ 3,086 | \$ 4,019 |
| Foreign currency translation adjustment | 34 | (479) | 408 | (127) |
| Comprehensive income | \$ 1,100 | \$ 1,208 | \$ 3,494 | \$ 3,892 |

Table of Contents

Lawson Products, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 9 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.

On March 17, 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. Through June 30, 2011, the Company had incurred \$0.8 million for legal services provided to Dr. Port in relation to this litigation of which \$0.1 million was incurred during the six months ended June 30, 2011.

Note 10 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 following table presents summary financial information for the Company's reportable segments:

| | (Amounts in thousands) | | | |
|---|------------------------|-----------|------------------|------------|
| | Three Months Ended | | Six Months Ended | |
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Net sales | | | | |
| MRO | \$ 80,625 | \$ 76,796 | \$ 159,880 | \$ 148,731 |
| OEM | 3,529 | 3,509 | 6,853 | 6,484 |
| Consolidated total | \$ 84,154 | \$ 80,305 | \$ 166,733 | \$ 155,215 |
| Operating income | | | | |
| MRO | \$ 1,921 | \$ 4,044 | \$ 6,266 | \$ 6,789 |
| OEM | 136 | (28) | 281 | (167) |
| Severance expense | (465) | (1,224) | (1,210) | (1,650) |
| Gain on sale of assets | | | | 1,701 |
| Legal settlement | | | | 550 |
| Consolidated total | \$ 1,592 | \$ 2,792 | \$ 5,337 | \$ 7,223 |
| Other income | 63 | 23 | 79 | 39 |
| Interest expense | (71) | (196) | (583) | (281) |
| Income from continuing operations before income taxes | \$ 1,584 | \$ 2,619 | \$ 4,833 | \$ 6,981 |

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Quarter ended June 30, 2011 compared to Quarter ended June 30, 2010**

The following table presents a summary of our financial performance for the three months ended June 30, 2011 and 2010:

| (\$ in thousands) | 2011 | | 2010 | |
|---|-----------|----------------|-----------|----------------|
| | Amount | % of Net Sales | Amount | % of Net Sales |
| Net sales | | | | |
| MRO | \$ 80,625 | 95.8% | \$ 76,796 | 95.6% |
| OEM | 3,529 | 4.2 | 3,509 | 4.4 |
| Consolidated total | \$ 84,154 | 100.0% | \$ 80,305 | 100.0% |
| Gross profit | | | | |
| MRO | \$ 47,653 | 59.1% | \$ 48,232 | 62.8% |
| OEM | 646 | 18.3 | 557 | 15.9 |
| Consolidated total | 48,299 | 57.4 | 48,789 | 60.8 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 46,242 | 54.9 | 44,773 | 55.8 |
| Severance expense | 465 | 0.6 | 1,224 | 1.5 |
| Operating income | 1,592 | 1.9 | 2,792 | 3.5 |
| Other expense, net | (8) | (0.0) | (173) | (0.2) |
| Income from continuing operations before income tax expense | | | | |
| Income tax expense | 1,584 | 1.9 | 2,619 | 3.3 |
| Income tax expense | 496 | 0.6 | 1,139 | 1.5 |
| Income from continuing operations | \$ 1,088 | 1.3% | \$ 1,480 | 1.8% |

Net Sales

Net sales for the second quarter of 2011 increased 4.8% to \$84.2 million, from \$80.3 million in the second quarter of 2010. Excluding the Canadian exchange rate impact, net sales increased 4.1% for the quarter.

MRO net sales increased 5.0% in the second quarter of 2011, to \$80.6 million from \$76.8 million in the prior year period, primarily reflecting continued growth within our national, governmental and automotive sectors of our business, partially offset by a moderation in our other sectors. MRO average daily sales increased to \$1.260 million in the second quarter of 2011 compared to \$1.200 million in the second quarter of 2010, driven by an increase in average daily orders and average order size.

OEM net sales of \$3.5 million in the second quarter of 2011 were relatively unchanged compared to the prior year quarter.

Gross Profit

Gross profit decreased \$0.5 million in the second quarter of 2011, to \$48.3 million from \$48.8 million in the prior year period. MRO gross profit as a percent of net MRO sales decreased to 59.1% in the second quarter of 2011, compared to 62.8% achieved in the second quarter of 2010. The decline reflects the strategic decision to pursue larger customers with slightly lower margins to better balance our account portfolio that should deliver sustained top-line growth, increased customer retention and margin dollar expansion over time. On a combined basis, national and government accounts represent approximately 17.8% of net sales for the quarter versus approximately 16.2% in the prior year quarter.

Table of Contents

OEM gross profit increased \$0.1 million and increased as a percent of OEM sales to 18.3% in the second quarter of 2011 from 15.9% in the second quarter of 2010, driven primarily by higher margin customers.

Selling, General and Administrative Expenses (SG&A)

SG&A expenses increased 3.3% to \$46.2 million in the second quarter of 2011 from \$44.8 million in 2010. As a percent of net sales, SG&A improved by 0.9 percentage points to 54.9% in the second quarter of 2011 compared to 55.8% in the second quarter of 2010.

Total selling expenses increased from \$20.7 million in the second quarter of 2010 to \$21.3 million in the second quarter of 2011 and decreased as a percent of net sales to 25.3% in 2011 from 25.8% in 2010. The decrease, as a percent of sales, reflects the changes of the district sales managers transitioning to full-time employees during 2010, the planned shift toward higher volume lower margin national customers that pay a lower commission and lower insurance costs.

Excluding total selling expenses, G&A expenses increased \$0.9 million. The increase was primarily driven by \$2.4 million of ERP implementation expenses partially offset by decreased stock based compensation expense of \$0.6 million and lower incentive compensation. Excluding ERP, G&A expenses decreased \$0.9 million or 3.9% for the quarter.

Severance Expense

Severance expense in the second quarter of 2011 was \$0.5 million compared to \$1.2 million in the second quarter of 2010. Severance expense in both 2011 and 2010 related to the elimination of certain positions associated with the realignment of various operating responsibilities.

Income Tax Expense

Income tax expense of \$0.5 million was recorded based on pre-tax income of \$1.6 million for the three months ended June 30, 2011, resulting in an effective tax rate of 31.3%. For the three months ended June 30, 2010, income tax expense was \$1.1 million based on pre-tax income of \$2.6 million, resulting in an effective tax rate of 43.5%. The 2011 tax rate decreased from 2010 primarily due to the effect of valuation expenses recorded in 2010.

Income from Continuing Operations

We reported income from continuing operations of \$1.1 million or \$0.13 per diluted share in the second quarter of 2011. Income from continuing operations for the second quarter of 2010 was \$1.5 million or \$0.17 per diluted share.

Table of Contents**Six Months ended June 30, 2011 compared to Six Months ended June 30, 2010**

The following table presents a summary of our financial performance for the six months ended June 30, 2011 and 2010:

| (\$ in thousands) | 2011 | | 2010 | |
|---|------------|-------------------|------------|-------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales |
| Net sales | | | | |
| MRO | \$ 159,880 | 95.9% | \$ 148,731 | 95.8% |
| OEM | 6,853 | 4.1 | 6,484 | 4.2 |
| Consolidated total | \$ 166,733 | 100.0% | \$ 155,215 | 100.0% |
| Gross profit | | | | |
| MRO | \$ 96,933 | 60.6% | \$ 94,158 | 63.3% |
| OEM | 1,305 | 19.0 | 956 | 14.7 |
| Consolidated total | 98,238 | 58.9 | 95,114 | 61.3 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 91,691 | 55.0 | 88,492 | 57.0 |
| Severance expense | 1,210 | 0.7 | 1,650 | 1.1 |
| Gain on sale of assets | | | (1,701) | (1.1) |
| Legal settlement | | | (550) | (0.4) |
| Operating income | 5,337 | 3.2 | 7,223 | 4.7 |
| Other expense, net | (504) | (0.3) | (242) | (0.2) |
| Income from continuing operations before income tax expense | | | | |
| Income tax expense | 4,833 | 2.9 | 6,981 | 4.5 |
| Income tax expense | 1,695 | 1.0 | 3,269 | 2.1 |
| Income from continuing operations | \$ 3,138 | 1.9% | \$ 3,712 | 2.4% |

Net Sales

Net sales for the first six months of 2011 increased 7.4% to \$166.7 million, from \$155.2 million in the first six months of 2010. Excluding the Canadian exchange rate impact, net sales increased 6.7% over the prior year period.

MRO net sales increased 7.5% in the first six months of 2011, to \$159.9 million from \$148.7 million in the prior year period, primarily reflecting continued growth within our national, governmental and automotive sectors of our business. MRO average daily sales increased to \$1.259 million in the first six months of 2011 compared to \$1.171 million in the first six months of 2010, driven by improvements in average orders per day and average order size.

OEM net sales increased 5.7% in the first six months of 2011, to \$6.9 million from \$6.5 million in the prior year period, driven by strength in our aerospace customer base and new customer growth.

Gross Profit

Gross profit increased \$3.1 million in the first six months of 2011, to \$98.2 million from \$95.1 million in the prior year period. MRO gross profit as a percent of net MRO sales decreased to 60.6% in the first six months of 2011, compared to 63.3% achieved in the prior year period, primarily due to the shift toward acquiring new customers at lower margins which should increase retention and allow for margin dollar expansion over time. On a combined basis, national and government accounts represent approximately 18.2% of net sales for the first six months of 2011 versus approximately 14.8% in the prior year period.

Table of Contents

OEM gross profit increased \$0.3 million and increased as a percent of OEM sales to 19.0% in the first six months of 2011 from 14.7% in the first six months of 2010. The improvement as a percent of sales was primarily driven by higher margin new business growth.

Selling, General and Administrative Expenses (SG&A)

SG&A expenses increased \$3.2 million or 3.6% to \$91.7 million in the first six months of 2011 from \$88.5 million in 2010. As a percent of net sales, SG&A improved by 2.0 percentage points to 55.0% in the first six months of 2011 compared to 57.0% in the prior year period.

Total selling expenses increased to \$41.6 million in the first six months of 2011 from \$40.5 million in the first six months of 2010 and decreased as a percent of net sales to 24.9% in 2011 from 26.1% in 2010. The decrease, as a percent of sales, reflects the changes of the district sales managers transitioning to full-time employees during 2010, the planned shift toward higher volume lower margin national customers that pay a lower commission and lower insurance costs.

Excluding total selling expenses, G&A expenses increased \$2.1 million or 4.3%. The increase was primarily driven by ERP implementation expenses of \$4.3 million partially offset by lower incentive compensation. Excluding ERP, G&A expenses decreased \$1.6 million or 3.4%.

Severance Expense

Severance expense was \$1.2 million in the first six months of 2011 compared to \$1.7 million in the first six months of 2010. Severance expense in both 2011 and 2010 was primarily due to the elimination of certain positions supporting distribution services related to divested businesses or associated with the realignment of various operating responsibilities.

Gain on Sale of Assets

During the first six months of 2010 we recorded a gain on sale of assets of \$1.7 million related to the sale of our Dallas, Texas distribution center.

Legal Settlement

In the first six months of 2010, we recorded a \$0.6 million benefit related to proceeds received from legal remedies related to the actions of several former sales agents and Share Corporation alleging, among other things, breach of contract and interference with customer relationships.

Other expense, net

Other expense, net of \$0.5 million in the first six months of 2011 relates primarily to interest assessed on unclaimed property settlements.

Income Tax Expense

Income tax expense of \$1.7 million was recorded based on pre-tax income of \$4.8 million for the six months ended June 30, 2011, resulting in an effective tax rate of 35.1%. For the six months ended June 30, 2010, income tax expense was \$3.3 million resulting in an effective tax rate of 46.8%. The 2011 tax rate decreased from 2010 primarily due to the effect of valuation expenses recorded in 2010.

Income from Continuing Operations

We reported income from continuing operations of \$3.1 million or \$0.36 per diluted share in the first six months of 2011. Income from continuing operations for the prior year period, which included the gain from the sale of the Dallas distribution center and a favorable legal settlement, was \$3.7 million or \$0.44 per diluted share. Excluding these items, income from continuing operations per diluted share in 2010 was \$0.30.

Table of Contents**Liquidity and Capital Resources**

Cash and cash equivalents were \$22.7 million on June 30, 2011 compared to \$40.6 million on December 31, 2010. Net cash used in operating activities was \$7.1 million for the first six months of 2011 compared to \$4.5 million for the first six months of 2010. The increase in cash used in operations was driven by increases in working capital during the first half of the year. Accounts receivable and inventories increased primarily to support business expansion while reductions in accrued expenses are primarily related to annual compensation plans which are traditionally made during the first half of the year.

Capital expenditures were \$7.7 million for the first six months of 2011 compared to \$3.6 million for the first six months of 2010. Capital expenditures related to the ERP implementation were \$5.6 million for the first six months of 2011. Overall, we anticipate the total cost of the ERP implementation, including both capital and expense, will range from \$25.0 million to \$28.0 million of which \$20.1 million has been incurred during 2010 and the first six months of 2011. We anticipate that total capital expenditures for 2011 will be \$12.0 to \$15.0 million.

The net outlay related to the sale of businesses in the first six months of 2011 consisted of a payment of approximately \$0.9 million due to the final value of Rutland's working capital that was sold in the fourth quarter of 2010, partially offset by \$0.5 million received as payment on the note receivable from the sale of ACS in the third quarter of 2010. Cash flows from investing activities in the first half of 2010 benefited from the receipt of \$2.0 million from the sale of our Dallas, Texas distribution center.

Net cash used in financing activities included dividend payments of \$2.0 million and \$1.5 million for the first six months of 2011 and 2010, respectively. In the first six months of 2010 we received \$5.2 million in net borrowings on our revolving credit line compared to no net borrowings on our revolving line of credit in 2011.

At June 30, 2011 we were in compliance with all covenants related to our revolving line of credit as detailed below:

| Covenant | Minimum Requirement | Actual |
|---|---------------------|----------------|
| Cash plus accounts receivable and inventory to debt ratio | 2.00:1.00 | 90.46:1.00 |
| Tangible net worth | \$55.0 million | \$94.1 million |
| Debt service ratio | 1.2 | 13.0 |

We believe that cash on hand, cash provided by future operations and our \$55.0 million revolving line of credit will be sufficient to fund our operating requirements, capital expenditures, ERP implementation and other commitments and obligations in the next twelve months.

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk at June 30, 2011 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of the end of the period covered by this report (the Evaluation Date). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that (i) the information relating to Lawson, including our consolidated subsidiaries, required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) include, without limitation, controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in the Company's internal control over financial reporting during the quarter ended June 30, 2011 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II
OTHER INFORMATION**

ITEMS 1, 2, 3 and 5 of Part II are inapplicable and have been omitted from this report.

ITEM 1A. RISK FACTORS

There have been no material changes in the Company's risk factors at June 30, 2011 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2010 with the exception of the following risk factor which has been updated to reflect the current risk.

One stockholder controls the voting rights of over 45% of the Company's outstanding shares.

At June 30, 2011, members of the Port family collectively beneficially owned approximately 49% 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. As a result, Dr. Port has sole voting power of over 45% of the Company's outstanding shares, which effectively permits him to control stockholder votes concerning the election of directors, by-law amendments, possible mergers, corporate control contests and other significant corporate transactions. The interests of Dr. Port may differ from those of other stockholders.

In addition, in filings with the Securities and Exchange Commission certain members of the Port family have indicated that they may sell their shares. Given the low historic trading volume of our common stock, such sales could reduce the market price of our common stock.

Table of Contents

ITEM 6. EXHIBITS

| Exhibit # | |
|-----------|--|
| 31.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 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 |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LAWSON PRODUCTS, INC.
(Registrant)

Dated July 28, 2011

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

Dated July 28, 2011

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