

Form 10-K  
(Mark  
One)

LAWSON PRODUCTS, INC.  
(Exact Name of Registrant as Specified in Charter)  
Delaware 36-2229304  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

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

|                                |                                                              |
|--------------------------------|--------------------------------------------------------------|
| Title of Each Class            | Name of Each Exchange on Which Registered                    |
| Common Stock, \$1.00 par value | The NASDAQ Stock Market LLC<br>(NASDAQ Global Select Market) |

None  
(Title of class)

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 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, 2016 (based upon the per share closing price of \$19.86) was approximately \$137,477,000.

As of January 31, 2017, 8,832,623 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” and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. These statements are based on management’s current expectations, intentions or beliefs and are subject to a number of factors, assumptions and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include the risk factors set forth in Item 1A of this Form 10-K.

The Company undertakes no obligation to update any such factors, assumptions and uncertainties 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. Any references to our website in this Annual Report on Form 10-K are not and should not be considered an incorporation of information including on our website into this Annual Report on Form 10-K.

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PART I

ITEM 1. BUSINESS.

Lawson Products, Inc. ("Lawson", the "Company", "we", "our", or "us") was incorporated in Illinois in 1952, and reincorporated in Delaware in 1982. Lawson serves the industrial, commercial, institutional and government Maintenance, Repair and Operations ("MRO") market.

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 by providing them with quality products, superior service and innovative solutions.

Industry and Competition

The MRO industrial distribution industry is comprised of companies that buy and stock products in bulk and supply these products to customers on an as needed basis. The customer benefits from our knowledge and the convenience of ordering smaller quantities maintained by MRO suppliers. We estimate that total annual revenue generated by the North American MRO marketplace exceeds \$130 billion.

There is a significant amount of competitive fragmentation by geography and product within the industry. We encounter 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 deliver quality products to our customers and offer them extensive product knowledge, product application expertise and Vendor Managed Inventory ("VMI") services. Our broad geographic sales coverage allows us to serve large multi-location customers. We compete for business primarily by offering a value-added service approach in which our highly trained sales representatives manage the product inventory for our customers. The VMI model makes it less likely that our customers will unintentionally run out of a product while optimizing their inventory levels.

Customers

During 2016, we sold products to over 70,000 customers with the largest customer accounting for approximately two percent of net sales. In 2016, approximately 91% of our net sales were generated in the United States and approximately 9% in 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. Although seasonality is not significant in our business, due to fewer selling days during the holiday season, net sales in the fourth quarter are historically slightly lower than the first three quarters of the year.

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 selling to and servicing small and medium sized customer locations that value our service approach.

Operations

Sales orders are primarily generated from our sales representatives; however, customers can also order directly from our website or through our customer service team via fax or phone. We ship products to customers in all 50 states, Puerto Rico, Canada, Mexico and the Caribbean. We normally ship to our customers within one day of order placement.

Our MRO distribution process normally entails the purchase of product from suppliers in bulk for delivery to our packaging and distribution facility in McCook, Illinois (“McCook Facility”) for possible repackaging, labeling or cross-docking. Product is then either stocked at the McCook Facility or delivered to one of our strategically located distribution centers. As orders are received, product is picked, packed and shipped to our customers. Many factors affect the efficiency of this process including the physical design of the distribution centers, routing logistics, the number of times the product needs to be handled, transportation costs and the flexibility to meet the specific requirements of our customers.

## Products

Our product offerings are listed on our website and in catalogs distributed to our customers. Sales percentages by broad product categories of our product mix in 2016 were as follows:

| Product Category                | Percentage |
|---------------------------------|------------|
| Fastening systems               | 21%        |
| Specialty chemicals             | 15%        |
| Fluid power                     | 15%        |
| Cutting tools and abrasives     | 15%        |
| Electrical                      | 12%        |
| Aftermarket automotive supplies | 9%         |
| Safety                          | 4%         |
| Welding and metal repair        | 2%         |
| Other                           | 7%         |
|                                 | 100%       |

We offer over 200,000 different core products for sale of which over 50,000 products are maintained in our distribution centers. 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 2016, we purchased products from approximately 2,300 suppliers and no single supplier accounted for more than five percent of our purchases. The loss of one of our core suppliers could affect our operations by hindering our ability to provide full service to our customers.

Our quality control department tests our product offerings to ensure they meet our customers' specifications. We recommend solutions to help customers maximize product performance and avoid costly product failures. Our engineering department 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. Safety Data Sheets are maintained electronically and are available to our customers on our website.

## Employees

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

On December 31, 2016, our workforce included approximately 1,590 individuals, comprised of approximately 1,130 in sales and marketing, approximately 390 in operations and distribution and approximately 70 in management and administration. Approximately 10% of our workforce is covered by three collective bargaining agreements. We believe that our relations with our employees and their collective bargaining organizations are good.

## Sales Team

On December 31, 2016, our sales and marketing team consisted of approximately 1,130 individuals focused on servicing existing customers, identifying new customers, providing customer service support and providing on-site customer service. Of our total sales team, 1,009 are sales representatives who are primarily organized into geographical regions. The performance of each region is the responsibility of a Regional Sales Director. 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 Director. Our District Sales Managers work with the sales representatives to generate sales from new and existing customers. We also have a team dedicated to the acquisition of larger national and mid-market accounts and a team dedicated to serving our governmental accounts. The national accounts are comprised of multi-location customers with a national scope.

Our sales team receives education in the best uses of our products, enabling them to provide customized solutions to address our customers' needs including technical expertise and on-site problem resolution. The VMI service we offer consists of managing our customers' inventory, ordering the right products in the optimal quantity and stocking the product for our customer when the product is delivered. The sales team also periodically provides product presentations to our customers that are designed to demonstrate how our products can improve their productivity. Additionally, we offer customized storage systems for improved organization and a more efficient work-flow.

### Strategic Focus

In 2017, our focus will be to continue to grow our sales organically and through acquisitions and further improve our operations to make Lawson our customers' first choice for products, services and solutions that improve their operating performance.

Our sales are directly affected by the size of our sales team and its territorial coverage. In 2016, we increased our sales team by 72 sales representatives and we plan to continue to expand our sales representative count during 2017. Our plan to expand the sales force is designed to identify under served territories that offer the greatest potential growth opportunity, locate and recruit talented sales representatives, provide them with the proper training, and successfully integrate them into our organization.

To acquire the best new sales talent and prepare them for success, we have developed an extensive talent acquisition strategy. We use both internal and external resources to identify and recruit the best available sales talent. Our exclusive training program is intended to provide new sales representatives with the tools they need to maximize their sales potential. As we increase our sales coverage, we anticipate a short-term decrease in average sales per day per sales representative, as new representatives build up customer relationships in their territories. Our 2017 financial results may also be impacted by increased training and other costs related to the sales force expansion. However, we believe that these short-term investments will result in future opportunities as we leverage the impact of top-line growth over our fixed operating costs.

We are also focused on increasing the productivity of our sales representatives. We strive to empower our sales representatives with the training, technology and support they need to maximize their sales potential while providing our customers with superior service and making it easy for them to do business with us. In addition to organic growth, we will continue to actively pursue acquisition opportunities which fit our service oriented MRO business model and are financially accretive to our organization.

In order to improve our operations, we utilize a Lean Six Sigma approach, which is a set of tools that allow a project team to analyze and improve selected business processes. The project teams work with the process owners to develop statistical measures to evaluate the effectiveness of the process, document the current components and process flow, examine the root cause and effect of current operations, design and implement new ways to improve performance and then measure the results for effectiveness. The Lean Six Sigma process is deeply ingrained in our culture as we have had well over 100 employees complete Lean Six Sigma training over the past three years and plan to continue this training program in the years to come. In 2017, we plan to complete some of the projects initiated in 2016 that are focused on improving the operations of our sales force and we have initiated additional Lean Six Sigma projects involving customer data and customer retention processes.

We believe our emphasis on continuous improvement will lead to further reductions in error rates, increased processing speed, reduction in cycle times, standardization of procedures and elimination of waste. This will enable us to become a more efficient and effective organization while providing our customers with the best purchasing experience possible.



## 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 accessing the SEC's website at <http://www.sec.gov> or by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington DC 20549. 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) or by calling (773) 304-5050. Information on our website is not incorporated by reference into this report. We also make available on our website our Code of Ethics, Corporate Governance Principles and the charters of the committees of our Board of Directors.

## Executive Officers of the Registrant

The executive officers of Lawson as of February 1, 2017 were as follows:

| Name              | Age | Year First Elected to Present Office | Position                                                                    |
|-------------------|-----|--------------------------------------|-----------------------------------------------------------------------------|
| Michael G. DeCata | 59  | 2012                                 | President and Chief Executive Officer                                       |
| Neil E. Jenkins   | 67  | 2004                                 | Executive Vice President, Secretary and General Counsel                     |
| Ronald J. Knutson | 53  | 2014                                 | Executive Vice President, Chief Financial Officer, Treasurer and Controller |
| Shane T. McCarthy | 48  | 2015                                 | Senior Vice President, Supply Chain and Business Development                |

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

Mr. DeCata was elected President and Chief Executive Officer in September 2012. Mr. DeCata previously served in a consulting capacity for several private equity firms, including Hamilton Robinson Capital Partners from 2009 until 2012. Mr. DeCata previously served on the Board of Directors of Crescent Electric Supply Company from 2008 to 2013.

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

Mr. Knutson was elected Executive Vice President, Chief Financial Officer, Treasurer and Controller in April 2014 and has served as Executive Vice President, Chief Financial Officer since July 2012. Mr. Knutson joined the Company as Senior Vice President, Chief Financial Officer effective November 2009.

Mr. McCarthy was elected Senior Vice President, Supply Chain and Business Development in December 2015 and previously served as Senior Vice President, Supply Chain since June 2014. Mr. McCarthy served as Senior Vice President, Operations from July 2012 to June 2014 and previously served as Vice President of Distribution and Logistics from April 2008 to June 2012.

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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, 2016, 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 or in certain sectors of the economy.

Any decline or uncertainty in the strength of the economy may lead to a 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 inventory. Contractions 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 and result in an increase in bad debt expense.

Adverse economic conditions could also affect our key suppliers and contractors. This could lead to us incurring additional expenses or result in delays in shipping products to our customers. Economic uncertainty can make it difficult for us to accurately predict future order activity and affect our ability to effectively manage inventory levels. There are no assurances that we would be able to establish alternative financing or obtain financing with terms similar to our present Loan Agreement.

Failure to adequately fund our operating and working capital needs through cash generated from operations and cash available through our Loan Agreement could negatively impact our ability to invest in the business and maintain our capital structure.

Our business requires investment in working capital and fixed assets. We fund these investments from cash generated from operations and funds available from our Loan Agreement. Failure to generate sufficient cash flow from operations or from our Loan Agreement could cause us to have insufficient funds to operate our business. Adequate funds may not be available when needed or may not be available on favorable terms.

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

Our Loan Agreement contains financial and other restrictive covenants. These covenants could adversely affect us by limiting our financial and operating flexibility as well as our ability to plan for and react to market conditions and to meet our capital needs. Failure to meet these covenant requirements could lead to higher financing costs, increased restrictions, reduce or eliminate our ability to borrow funds, or accelerate the payment of our existing indebtedness. If we require more liquidity than is currently available to us under our Loan Agreement, we may need to raise additional funds through debt or equity offerings which may not be available when needed or may not be available on terms favorable to us. Should funding be insufficient at any time in the future, we may be unable to develop or enhance our products or services, take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our business, financial condition and results of operations.

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, if large amounts of shares are sold in the market, if there is index trading, or if investors have concerns that our business, financial condition, results of operations and capital requirements are negatively impacted by an economic downturn.

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.

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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 our ability to maintain core products in inventory, deliver products to our customers on a timely basis or adversely affect demand for our products, which may in turn adversely affect our results of operations.

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 overall changes in the product mix demand of our customers. When customers or 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, prices charged, additional freight costs or lower productivity levels, could cause our gross profit margin percentage to decline. Our gross margin percentage may also come under pressure in the future if we increase the percentage of national accounts in our customer base, as sales to these customers are generally at lower margins.

Changes 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, brass) and increases in 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. Additionally, continued low oil prices may result in weaker demand from oil and gas customers in the future, resulting in lower net sales.

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 serve 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. Disruptions 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.

Cyber attacks or other information security breaches could have a material adverse effect on our operating results and financial condition, subject us to additional legal costs and damage our reputation in the marketplace.

We are increasingly dependent on digital technology to process and record financial and operating data and communicate with our employees and business partners. During the normal course of business we receive, retain and transmit certain confidential information that our customers provide to us to purchase products or services or otherwise communicate with us.

Our technologies, systems, networks, and those of our business partners may become the target of cyber attacks or information security breaches that could result in the unauthorized release, misuse, loss or destruction of proprietary

and other information, or other disruption of our business operations, subject us to additional legal costs and damage our reputation in the marketplace. Although to date we have not experienced any losses relating to cyber attacks, there can be no assurance that we will not suffer such losses in the future. As cyber threats continue to evolve, we may be required to expend additional resources to continue to modify or enhance our protective measures or to investigate and fix any information security vulnerabilities.

The inability to successfully recruit, integrate and retain productive sales representatives could adversely affect our operating results.

We have committed to a plan to increase the size of our sales force which we believe will lead to increased sales and improve our long-term financial results. A successful expansion in our sales force requires us to identify under served territories that offer the greatest potential growth opportunity, locate and recruit talented sales representatives, provide them with the proper training, and successfully integrate them into our organization. This expansion plan requires significant investment in capital and resources. The failure to identify the optimal sales territories, recruit and retain quality sales representatives and provide them with sufficient

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support could adversely affect our operating results. Additionally, we anticipate a short-term decrease in average sales per day per sales representative as new representatives build up customer relationships in their territories.

It is also critical to retain the experienced and productive sales representatives that have historically contributed to our success. Failure to retain a sufficient number of talented, experienced and productive sales representatives could adversely affect our financial and operating results.

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 employees could have a material adverse effect on our business.

The inability of management to successfully implement changes in operating processes, could lead to disruptions in our operations.

We are continually striving to improve operational efficiencies throughout our organization and to identify and initiate changes intended to improve our internal operations. The implementation of changes to our current operations involve a risk that the changes may not work as intended, may disrupt related processes, may not be properly applied or may not result in accomplishing the intended efficiencies. Failure to successfully manage the implementation of these changes could lead to disruptions in our operations.

The inability to successfully integrate acquisitions into our organization could adversely affect our operations and operating results.

One of our growth strategies is to actively pursue acquisition opportunities which fit our service oriented MRO business model. Failure to successfully identify the right opportunities and to successfully integrate their operations into our organization could adversely affect our operations and our operating results.

The Company operates in highly competitive markets.

The MRO marketplace is highly competitive. Our competitors include large and small companies with similar or greater market presence, name recognition, and financial, marketing, and other resources. We believe the competition will continue to challenge our business with their product selection, financial resources and services.

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.

A violation of Federal, state or local environmental protection regulations could lead to significant penalties and fines or other remediation costs.

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 these products. Failure to comply with these regulations

could lead to severe penalties and fines for each violation.

Additionally, a facility we own in Decatur, Alabama, was found to contain hazardous substances in the soil and groundwater as a result of historical operations prior to our ownership. We retained an environmental consulting firm to further investigate the contamination, including measurement and monitoring of the site. The Company has concluded that further remediation will most likely be required, and accordingly, has made an accrual for the estimated cost of this environmental matter. An agreement with Alabama's voluntary cleanup program has not yet been reached regarding these remediation approaches and additional procedures may be required to remediate the situation that could negatively impact our operating results.

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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 continue to affect our ability to realize the deferred tax assets on our balance sheet, which could affect our results of operations.

## ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

## ITEM 2. PROPERTIES.

At December 31, 2016, we owned or leased the following facilities:

| Location                             | Function               | Approximate Square Footage | Own/Lease | Lease Expiration |
|--------------------------------------|------------------------|----------------------------|-----------|------------------|
| United States                        |                        |                            |           |                  |
| Chicago, Illinois <sup>(1)</sup>     | Headquarters           | 86,300                     | Lease     | March 2023       |
| McCook, Illinois                     | Packaging/Distribution | 306,800                    | Lease     | June 2022        |
| Reno, Nevada                         | Distribution           | 105,200                    | Lease     | June 2024        |
| Suwanee, Georgia                     | Distribution           | 91,200                     | Own       |                  |
| Fairfield, New Jersey <sup>(2)</sup> | Distribution           | 60,000                     | Own       |                  |
| Decatur, Alabama <sup>(3)</sup>      | Lease                  | 88,200                     | Own       |                  |
| Canada                               |                        |                            |           |                  |
| Mississauga, Ontario                 | Distribution           | 78,000                     | Own       |                  |

(1) We have sub-leased approximately 17,100 feet of the Chicago, Illinois headquarters through March 2023.

In 2016, primarily due to excess capacity within our supply chain, we announced the closure of our Fairfield, New Jersey distribution center. We plan to discontinue use of the facility in the first quarter of 2017 and anticipate selling the facility for a gain in 2017.

(3) In connection with the sale of a discontinued business, we have agreed to lease the Decatur property to the buyer through February, 2019.

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

## 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.

## ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable



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## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

## Stock Price Data

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.

|                | 2016    |         | 2015    |         |
|----------------|---------|---------|---------|---------|
|                | High    | Low     | High    | Low     |
| First Quarter  | \$22.80 | \$15.23 | \$27.84 | \$22.97 |
| Second Quarter | 22.50   | 16.42   | 25.00   | 19.20   |
| Third Quarter  | 21.61   | 15.28   | 28.56   | 21.10   |
| Fourth Quarter | 25.80   | 16.69   | 29.64   | 20.88   |

On January 31, 2017, the closing sales price of our common stock was \$25.85 and the number of stockholders of record was 395. We did not issue dividends in either 2016 or 2015 and, although the Company currently has no plans to issue dividends in the foreseeable future, it will continue to consider the best use of funds for our stockholders. The amount of dividends we can issue is restricted to \$7.0 million annually under our Loan and Security Agreement ("Loan Agreement"). Information about our equity compensation plans may be found in item 12 of this report which is hereby incorporated by reference.

## Repurchased Shares of Stock

The following table summarizes the repurchases of the Company's Common Stock for the three months ended December 31, 2016. These shares were purchased for the sole purpose of satisfying tax withholding obligations of certain employees upon the vesting of restricted stock awards granted to them by the Company. No shares were repurchased in the open market.

| Period                             | (a)<br>Total<br>number<br>of shares<br>(or units)<br>purchased | (b)<br>Average<br>price<br>paid<br>per<br>share<br>(or<br>unit) | (c)<br>Total<br>number<br>of shares<br>(or<br>units)<br>purchased<br>as part<br>of<br>publicly<br>announced<br>plans or<br>programs | (d)<br>Maximum number (or approximate dollar value) of shares that<br>may yet be purchased under the plans or programs |
|------------------------------------|----------------------------------------------------------------|-----------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------|
| October 1 to October 31,<br>2016   | —                                                              | \$                                                              | —                                                                                                                                   | —                                                                                                                      |
| November 1 to<br>November 30, 2016 | —                                                              | —                                                               | —                                                                                                                                   | —                                                                                                                      |
| December 1 to December<br>31, 2016 | 6,194                                                          | 25.40                                                           | —                                                                                                                                   | —                                                                                                                      |

|                                         |       |   |
|-----------------------------------------|-------|---|
| Three months ended<br>December 31, 2016 | 6,194 | — |
|-----------------------------------------|-------|---|

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### Stock Price Performance Chart

Set forth below is a line graph comparing the yearly change in the cumulative total stockholder return of the Company's common stock against the cumulative total return of the Russell Microcap Index and a peer group (the "Peer Group") of the Company for the five prior years. The Company selected the Russell Microcap Index because Lawson is a component of the index and the market capitalization of the other member companies are similar to Lawson's market capitalization. The Peer Group consists of W.W. Grainger, Inc., Fastenal Company, and MSC Industrial Direct. The Company believes that the Peer Group is representative of the markets it serves in terms of product sales and customers. The chart below represents the hypothetical return, including reinvestment of dividends, on \$100 if it was invested on December 31, 2011 in the respective stocks or index fund.

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## 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 in Item 8 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, 2016 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.

|                                                            | (Dollars in thousands, except per share data) |             |            |            |             |
|------------------------------------------------------------|-----------------------------------------------|-------------|------------|------------|-------------|
|                                                            | 2016                                          | 2015<br>(1) | 2014 (2)   | 2013 (3)   | 2012 (4)    |
| Net sales                                                  | \$276,573                                     | \$275,834   | \$285,693  | \$269,503  | \$273,562   |
| Income (loss) from continuing operations                   | \$(1,629 )                                    | \$297       | \$(6,061 ) | \$(6,981 ) | \$(64,033 ) |
| Income from discontinued operations                        | —                                             | —           | 1,692      | 1,861      | 1,483       |
| Net income (loss)                                          | \$(1,629 )                                    | \$297       | \$(4,369 ) | \$(5,120 ) | \$(62,550 ) |
| Basic and diluted income (loss) per share of common stock: |                                               |             |            |            |             |
| Continuing operations                                      | \$(0.19 )                                     | \$0.03      | \$(0.70 )  | \$(0.81 )  | \$(7.46 )   |
| Discontinued operations                                    | —                                             | —           | 0.20       | 0.22       | 0.18        |
| Net income (loss)                                          | \$(0.19 )                                     | \$0.03      | \$(0.50 )  | \$(0.59 )  | \$(7.28 )   |
| Cash dividends declared per share                          | \$—                                           | \$—         | \$—        | \$—        | \$0.24      |
| Total assets                                               | \$135,307                                     | \$133,094   | \$137,840  | \$159,945  | \$172,931   |
| Noncurrent liabilities                                     | \$34,737                                      | \$35,487    | \$37,257   | \$39,083   | \$42,370    |
| Stockholders' equity                                       | \$61,133                                      | \$61,264    | \$61,855   | \$65,912   | \$70,733    |

## Notes:

The 2015 results from continuing operations include an expense of \$0.9 million related to an increase in the (1) estimated future remediation cost of an environmental matter involving land owned in Decatur, Alabama, that was part of a division that was previously sold.

The 2014 results from continuing operations include a \$3.0 million impairment charge related to the Reno, Nevada, (2) distribution center and a charge of \$0.3 million related to the initial estimate of remediation of the environmental matter at the Decatur, Alabama, facility.

(3) The 2013 results from continuing operations include a \$2.9 million charge related to the sub-lease of a portion of the leased headquarters and a \$0.4 million benefit from the resolution of an employment tax matter.

The 2012 results from continuing operations include a goodwill impairment charge of \$28.3 million, an increase in (4) income tax expense of \$33.3 million due to an increase in the deferred tax valuation allowance, a \$3.9 million charge related to discontinuing certain products and a \$3.7 million gain on the sale of assets.



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

#### Overview

We operate in one reportable segment: as a distributor of products and services to the industrial, commercial, institutional, and governmental maintenance, repair and operations ("MRO") marketplace.

The North American MRO industry is highly fragmented. We compete for business with several national distributors as well as a large number of regional and local distributors. The MRO business is significantly influenced by the overall strength of the manufacturing sector of the U.S. economy. One measure used to evaluate the strength of the industrial products market is the PMI index published by the Institute for Supply Management. The PMI index is a composite index of economic activity in the United States manufacturing sector. It is published by the Institute for Supply Management and is available at <https://www.instituteforsupplymanagement.org>. A measure of that index above 50 generally indicates expansion of the manufacturing sector while a measure below 50 generally represents contraction. The average monthly PMI was 51.5 for the year ended December 31, 2016 compared to 51.3 for the year ended December 31, 2015 indicating a slight improvement in 2016 in the U.S. manufacturing economy compared to the prior year primarily occurring in the second half of the year.

Our sales are also affected by the number and effectiveness of sales representatives and the amount of sales each representative can generate, which we measure as average sales per day per sales representative. In 2016, we increased the number of sales representatives, by 72 net new sales representatives, to a total of 1,009 at December 31, 2016. We plan to continue to expand our sales representative count by the end of 2017. While we anticipate future sales growth from our expanded sales force, we also anticipate a short-term decrease in average sales per day per sales representative, as new representatives build up customer relationships in their territories.

Results of operations are examined in detail following a recap of our major activities in 2016.

#### 2016 Activities

Increased Sales Team - We increased the number of net active sales representatives by approximately 8% to 1,009 on December 31, 2016 from 937 on December 31, 2015.

Acquisitions - We completed three acquisitions in 2016. Mattic Industries LTD located in western Canada, F.B Feeney Hardware located in Ontario, Canada and Perfect Products Company of Michigan.

Streamlined supply chain - In 2016, primarily due to excess capacity within our supply chain, we announced the closure of our Fairfield, New Jersey distribution center. We plan to discontinue use of the facility in the first quarter of 2017 and anticipate selling the facility for a gain in 2017.

Amended Loan Agreement - We extended the maturity date of our Loan Agreement to August 8, 2020, expanded the amount of credit available by increasing the borrowing base, removed certain financial covenant reporting requirements and reduced the unused borrowing fees.

Lean Six Sigma - Over the past three years we have had well over 100 employees complete Lean Six Sigma training, which is a systematic data driven approach to analyzing and improving business processes.

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Improved Operational Performance - We continued to improve the fundamentals of our business, measured as improved customer service levels to our customers.

We believe we have created a scalable infrastructure that will allow us to take full advantage of future growth opportunities. We continue to strive to be our customers' first choice for maintenance, repair and operational solutions.

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## RESULTS OF OPERATIONS FOR 2016 AS COMPARED TO 2015

| (Dollars in thousands)                                             | Year Ended December 31,<br>2016 |                      | 2015      |                      | Year-to-Year<br>Change |       |
|--------------------------------------------------------------------|---------------------------------|----------------------|-----------|----------------------|------------------------|-------|
|                                                                    | Amount                          | % of<br>Net<br>Sales | Amount    | % of<br>Net<br>Sales | Amount                 | %     |
| Net sales                                                          | \$276,573                       | 100.0 %              | \$275,834 | 100.0 %              | \$739                  | 0.2 % |
| Cost of goods sold                                                 | 108,511                         | 39.2                 | 106,710   | 38.7                 | 1,801                  | 1.7   |
| Gross profit                                                       | 168,062                         | 60.8                 | 169,124   | 61.3                 | (1,062 )               | (0.6) |
| Operating expenses:                                                |                                 |                      |           |                      |                        |       |
| Selling expenses                                                   | 92,908                          | 33.6                 | 90,093    | 32.7                 | 2,815                  | 3.1   |
| General and administrative expenses                                | 76,611                          | 27.7                 | 75,979    | 27.5                 | 632                    | 0.8   |
| Total SG&A                                                         | 169,519                         | 61.3                 | 166,072   | 60.2                 | 3,447                  | 2.1   |
| Other operating expenses                                           | —                               | —                    | 931       | 0.3                  | (931 )                 |       |
| Total operating expenses                                           | 169,519                         | 61.3                 | 167,003   | 60.5                 | 2,516                  |       |
| Operating (loss) income                                            | (1,457 )                        | (0.5 )               | 2,121     | 0.8                  | (3,578 )               |       |
| Interest and other expenses, net                                   | (74 )                           | (0.1 )               | (969 )    | (0.4 )               | 895                    |       |
| Income (loss) from continuing operations before income tax expense | (1,531 )                        | (0.6 )               | 1,152     | 0.4                  | (2,683 )               |       |
| Income tax expense                                                 | 98                              | —                    | 855       | 0.3                  | (757 )                 |       |
| Income (loss) from continuing operations                           | \$(1,629 )                      | (0.6 )%              | \$297     | 0.1 %                | \$(1,926)              |       |

## Net Sales

Net sales increased 0.3% in 2016 to \$276.6 million from \$275.8 million in 2015, primarily due to an increase in sales by our Kent Automotive and Government divisions, growing current strategic account relationships and sales generated by acquisitions. This was partially offset by a general slow-down in the MRO marketplace, a decrease in the Canadian exchange rate and a decrease in sales of \$2.6 million to oil and gas customers. Average daily sales, defined as net sales divided by the 252 business days in each year, were \$1.098 million in 2016 compared to \$1.095 million in 2015.

## Gross Profit

Gross profit decreased to \$168.1 million or 60.8% of net sales in 2016 from \$169.1 million or 61.3% of net sales a year ago. Product margin remained consistent versus 2015, however, the gross margin percentage was lower due to increased net freight expense and additional labor expenses related to repackaging inventory from acquisitions and additional labor and freight costs incurred as a result of rebalancing and refining our inventory forecasting process.

## Selling Expenses

Selling expenses consist of compensation paid to our sales representatives and related expenses to support our sales efforts. Selling expenses increased \$2.8 million to \$92.9 million in 2016 from \$90.1 million in 2015 primarily driven by expenses related to the increase in the number of sales representatives. This increase was partially offset by \$1.9 million of expense related to the North American sales meeting incurred in 2015 which was not held in 2016.

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General and Administrative Expenses

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses increased \$0.6 million to \$76.6 million in 2016 from \$76.0 million in 2015, driven by an increase of \$1.1 million in severance expense, primarily related the closure of the Fairfield, New Jersey distribution center, and increases in compensation including an increase of \$0.4 million in stock-based compensation of which a portion varies with our stock price. These increases were partially offset by decreases across many other expense categories as a result of cost reduction efficiencies.

Other Operating Expenses

In 2015 we accrued \$0.9 million related to estimated future remediation of an environmental matter involving land owned in Decatur, Alabama, that was part of a division that was previously sold in 2014. The estimated cost of remediation will most likely be adjusted in future years as more information becomes available.

Interest and Other Expenses, Net

Interest and other expenses, net decreased to \$0.1 million in 2016 from \$1.0 million in 2015 due primarily to an increase of \$0.5 million in foreign currency transaction gains, a \$0.1 million decrease in interest expense from our revolving credit facility due to a lower average debt balance and an increase of \$0.1 million in interest income.

Income Tax Expense

Due to historical cumulative losses, in 2012, we determined it was more likely than not we would not be able to utilize our deferred tax assets to offset future taxable income. Therefore, substantially all of our deferred tax assets are subject to a tax valuation allowance. However, due to recent reductions in these losses resulting in net income in certain periods, it may become necessary to reduce all or a portion of the valuation allowance resulting in a decrease to income tax expense for the period in which the reduction is recorded. Although we are in a full tax valuation allowance position, income tax expense of \$0.1 million and \$0.9 million was recorded in 2016 and 2015, respectively, primarily due to state taxes and adjustments to reserves for uncertain tax positions.

Income (Loss) from Continuing Operations

We reported a loss from continuing operations of \$1.6 million in 2016 compared to income from continuing operations of \$0.3 million in 2015.

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## RESULTS OF CONTINUING OPERATIONS FOR 2015 AS COMPARED TO 2014

| (Dollars in thousands)                                             | Year Ended December 31,<br>2015 |                      | 2014       |                      | Year to Year<br>Change |        |
|--------------------------------------------------------------------|---------------------------------|----------------------|------------|----------------------|------------------------|--------|
|                                                                    | Amount                          | % of<br>Net<br>Sales | Amount     | % of<br>Net<br>Sales | Amount                 | %      |
| Net sales                                                          | \$275,834                       | 100.0 %              | \$285,693  | 100.0 %              | \$(9,859)              | (3.5)% |
| Cost of goods sold                                                 | 106,710                         | 38.7                 | 113,144    | 39.6                 | (6,434 )               | (5.7)  |
| Gross profit                                                       | 169,124                         | 61.3                 | 172,549    | 60.4                 | (3,425 )               | (2.0)  |
| Operating expenses:                                                |                                 |                      |            |                      |                        |        |
| Selling expenses                                                   | 90,093                          | 32.7                 | 90,776     | 31.8                 | (683 )                 | (0.8)  |
| General and administrative expenses                                | 75,979                          | 27.5                 | 83,350     | 29.1                 | (7,371 )               | (8.8)  |
| Total SG&A                                                         | 166,072                         | 60.2                 | 174,126    | 60.9                 | (8,054 )               | (4.6)  |
| Other operating expenses, net                                      | 931                             | 0.3                  | 3,386      | 1.2                  | (2,455 )               |        |
| Total operating expenses                                           | 167,003                         | 60.5                 | 177,512    | 62.1                 | (10,509 )              |        |
| Operating income (loss)                                            | 2,121                           | 0.8                  | (4,963 )   | (1.7 )               | 7,084                  |        |
| Interest and other expenses, net                                   | (969 )                          | (0.4 )               | (871 )     | (0.3 )               | (98 )                  |        |
| Income (loss) from continuing operations before income tax expense | 1,152                           | 0.4                  | (5,834 )   | (2.0 )               | 6,986                  |        |
| Income tax expense                                                 | 855                             | 0.3                  | 227        | 0.1                  | 628                    |        |
| Income (loss) from continuing operations                           | \$297                           | 0.1 %                | \$(6,061 ) | (2.1 )%              | \$6,358                |        |

## Net Sales

Net sales decreased 3.5% in 2015 to \$275.8 million from \$285.7 million in 2014. Sales in 2015 were negatively impacted by a general slow-down in the MRO marketplace which manifested in the second half of the year, weak demand from customers operating in the oil and gas industry, and a decrease in the Canadian exchange rate. Sales to oil and gas customers declined \$5.9 million. This was partially offset by an increase in sales by our Kent Automotive Division and growing current strategic account relationships. Average daily sales were \$1.095 million in 2015 compared to \$1.134 million in 2014

## Gross Profit

Gross profit decreased 2.0% in 2015, however, increased as a percent of net sales to 61.3% from 60.4% in 2014 due primarily to lower purchasing costs along with improved distribution efficiencies.

## Selling Expenses

Selling expenses decreased \$0.7 million to \$90.1 million in 2015 from \$90.8 million in 2014 primarily driven by lower commission expense on lower sales and lower performance-based compensation. These decreases were partially offset by \$1.9 million of expense related to the North American sales meeting which was not held in 2014 and

expenses associated with newly hired sales representatives. Selling expenses increased as a percent of net sales to to 32.7% from 31.8% in 2014.

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### General and Administrative Expenses

General and administrative expenses decreased \$7.4 million to \$76.0 million in 2015 from \$83.4 million in 2014. A decrease of \$4.3 million in stock-based compensation of which a portion varies with our stock price, and a decrease in other compensation of \$3.2 million, combined with decreases across many other expense categories as a result of cost reduction efficiencies, were offset partially by an increase of \$0.6 million in severance expense and a favorable legal settlement of \$0.7 million in 2014.

### Other Operating Expenses, Net

In 2015 and 2014 we accrued \$0.9 million and \$0.3 million, respectively, related to estimated future remediation of an environmental matter involving land owned in Decatur, Alabama, that was part of a division that was previously sold in 2014.

In 2014, we completed the sale of our Reno, Nevada, distribution center. As part of the review of the impact of a prospective sale, we determined that the full carrying amount of the asset was not recoverable. Therefore, we recorded a \$3.0 million non-cash impairment charge prior to the sale. In conjunction with the sale, we entered into an agreement to leaseback, for a 10-year term, approximately one-half of the building that we were previously using.

### Interest and Other Expenses, Net

Interest and other expenses, net increased to \$1.0 million in 2015 from \$0.9 million in 2014 due primarily to \$0.2 million of interest recorded in 2015 related to the settlement of a Canadian tax matter (see Note 12 - Commitments and Contingencies of the Consolidated Financial Statements included in Item 8 of this Form 10-K for further details) partially offset by a decrease in interest expense from our revolving credit facility due to a lower average debt balance during 2015.

### Income Tax Expense

Due to historical cumulative losses, in 2012, we determined that it was more likely than not that we would not be able to utilize our deferred tax assets to offset future taxable income. Therefore, substantially all of our deferred tax assets are subject to a tax valuation allowance. Although we are in a full tax valuation allowance position, an income tax expense of \$0.9 million and \$0.2 million were recorded in 2015 and 2014, respectively. The 2015 tax expense was due to state taxes, reserves for uncertain tax positions and the settlement of a Canadian tax matter. The 2014 tax expense was due to state taxes, reserves for uncertain tax positions, partially offset by the allocation of income taxes between continuing and discontinued operations.

### Income (Loss) from Continuing Operations

We reported income from continuing operations of \$0.3 million in 2015 compared to a loss from continuing operations of \$6.1 million in 2014. The 2014 results were negatively affected by the one-time \$3.0 million impairment charge related to the sale of the Reno, Nevada, distribution center.

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### LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$8.5 million, \$9.3 million and \$1.8 million in 2016, 2015 and 2014, respectively, primarily reflecting operating results, net of depreciation and amortization.

Capital expenditures were \$3.1 million, \$2.3 million and \$2.8 million in 2016, 2015 and 2014, respectively, were primarily for improvements to our distribution centers and information technology. We invested \$6.0 million and \$0.4 million in 2016 and 2015, respectively, in business acquisitions.

#### Loan Agreement

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

We have the ability to borrow funds through the Loan Agreement which consists of a \$40.0 million revolving credit facility which includes a \$10.0 million sub-facility for letters of credit. The terms of the Loan Agreement as amended are more fully detailed in Note 9 – Loan Agreement of the Consolidated Financial Statements included in Item 8 of this Form 10-K.

At December 31, 2016, we had \$0.8 million borrowings on our revolving line of credit under the Loan Agreement and had borrowing availability of \$35.0 million.

In addition to other customary representations, warranties and covenants, and if the excess capacity is below \$10.0 million, we are required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement, and a minimum quarterly tangible net worth level as defined in the amended Loan Agreement. On December 31, 2016, our borrowing capacity exceeded \$10.0 million, therefore, we were not subject to these financial covenants, however, for informational purposes we have provided the results of the financial covenants below:

| Quarterly Financial Covenants | Requirement    | Actual         |
|-------------------------------|----------------|----------------|
| EBITDA to fixed charges ratio | 1.10 : 1.00    | 1.75 : 1.00    |
| Minimum tangible net worth    | \$45.0 million | \$48.6 million |

Although we have met the minimum financial covenant levels for all quarters since the Loan Agreement was put in place including the quarter ended December 31, 2016, failure to meet these covenant requirements in future quarters could lead to higher financing costs, increased restrictions, or reduce or eliminate our ability to borrow funds.

No cash dividends were paid in the three years ended December, 31 2016 and dividends are currently restricted under our Loan Agreement to amounts not to exceed \$7.0 million annually.

We believe cash expected to be provided by operations and the funds available under our Loan Agreement are sufficient to fund our operating requirements, strategic initiatives and capital improvements throughout 2017.

### DISCONTINUED OPERATIONS

In February 2014, we completed the sale of substantially all of the assets of our non-core ASMP business for \$12.5 million plus the assumption of certain liabilities and recorded a \$1.5 million pre-tax gain on the sale. We retained

ownership of the Decatur, Alabama, facility, where ASMP was located, and are leasing it back to the buyer of the business. ASMP generated pre-tax operating earnings of \$0.3 million in 2014.

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## CONTRACTUAL OBLIGATIONS

Contractual obligations that require cash payments over future periods at December 31, 2016 were as follows:

| (Dollars in thousands)                  | Payments due in years ended<br>December 31, |          |             |             |            |
|-----------------------------------------|---------------------------------------------|----------|-------------|-------------|------------|
|                                         | Total                                       | 2017     | 2018 – 2019 | 2020 – 2021 | Thereafter |
| Revolving line of credit <sup>(1)</sup> | \$841                                       | \$841    | \$—         | \$—         | \$—        |
| Operating leases <sup>(2)</sup>         | 12,756                                      | 1,896    | 3,736       | 3,876       | 3,248      |
| Financing lease obligation              | 7,476                                       | 1,255    | 2,743       | 2,936       | 542        |
| Capital leases                          | 259                                         | 124      | 135         | —           | —          |
| Security bonus plan <sup>(3)</sup>      | 14,272                                      | 56       | —           | —           | 14,216     |
| Deferred compensation                   | 5,240                                       | 410      | 348         | 135         | 4,347      |
| Purchase commitments                    | 8,321                                       | 8,321    | —           | —           | —          |
| Severance obligation                    | 1,710                                       | 1,428    | 282         | —           | —          |
| Total contractual cash obligations      | \$50,875                                    | \$14,331 | \$7,244     | \$6,947     | \$22,353   |

The revolving line of credit with The PrivateBank expires in August 2020. Due to the lock box arrangement and a (1) subjective acceleration clause contained in the borrowing agreement, the revolving line of credit is classified as a current contractual obligation.

(2) Operating lease obligations are partially offset by future proceeds of \$0.6 million from a sub-lease expiring in March 2023.

Payments to participants in our security bonus plan are made on a lump sum basis at time of separation from the (3) 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.

## OFF-BALANCE SHEET ARRANGEMENTS

Of the \$12.8 million operating lease obligation, \$7.5 million relates to a lease agreement for our headquarters which expires in March 2023, and \$3.6 million relates to a lease agreement for our Reno, Nevada, distribution center which expires in June 2024. The remainder of the operating leases relate to the lease of warehouse and office equipment. The lease obligation associated with our headquarters is partially offset by \$0.6 million of total future minimum lease proceeds from a portion of the leased headquarters that has been sub-leased through March of 2023.

Also, as of December 31, 2016, we had contractual commitments to purchase \$8.3 million of product from our suppliers and contractors.

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CRITICAL ACCOUNTING POLICIES

We have disclosed our significant accounting policies in Note 2 to the consolidated financial statements. The following provides 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, 2016, our reserve was 1.5% of our gross accounts receivable outstanding. A hypothetical change of one percent to our reserve as a percent of our gross accounts receivable would have affected our annual doubtful accounts expense by approximately \$0.3 million.

**Inventory Reserves** — Inventories consist principally of finished goods and are stated at the lower of cost (determined using the 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.

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 of our current inventory activity. We use estimates to determine the necessity of recording these reserves based on periodic detailed analysis, 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 category and product obsolescence. In general, depending on the product category, we reserve inventory with low turnover at higher rates than inventory with higher turnover.

At December 31, 2016, our inventory reserve was \$5.5 million, equal to approximately 11.4% of our total inventory. A hypothetical change of one percent to our reserve as a percent of total inventory would have affected our cost of goods sold by \$0.5 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 (i.e. greater than 50% likely) 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. 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. 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 uncertain tax positions.

Primarily due to cumulative losses incurred in recent years, management determined that it was more likely than not that we will not be able to utilize our deferred tax assets to offset future taxable income and have established a deferred tax valuation allowance equal to substantially all of our net tax assets. A tax valuation allowance will remain until the Company can establish that the recoverability of its deferred tax assets is more likely than not.

Goodwill Impairment – 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 multi-step process. First, qualitative factors are reviewed to determine if it is more likely than not that the fair value of the reporting unit is greater than the carrying value. If we determine that it is more likely than not that the fair value

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of the reporting unit is greater than the carrying value of the reporting unit, then no further impairment testing is needed. If we determine that it is more likely than not that the carrying value of the reporting unit is greater than the fair value, the next step will be to compare the fair value of the reporting unit with the carrying value. If the fair value of the reporting unit exceeds the carrying value, goodwill is not considered to be impaired and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the third step of the goodwill test is performed to measure the amount of impairment loss, if any.

**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 exchange rate would have affected our 2016 net sales by \$2.6 million and net assets by \$2.0 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% increase in the price of our common stock on December 31, 2016 would have decreased our 2016 operating results by \$1.4 million and a hypothetical decrease of 10% in the price would have increased our 2016 operating results by \$0.6 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, 2016, the liability, which is based on the performance of these funds, was \$5.2 million. Additionally, we have invested funds in life insurance policies on certain executives. As of December 31, 2016, the cash surrender value of life insurance policies invested in financial instruments similar to those supporting the deferred compensation liability was \$10.0 million. Therefore, any future net increase or decrease in the market value of the deferred compensation liability would be offset by the performance of the portfolio of the cash value of the life insurance asset and the combined gain and loss would have no material effect on our financial results.

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.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The following information is presented in this item:

|                                                                                                                          |           |
|--------------------------------------------------------------------------------------------------------------------------|-----------|
| <u>Report of Independent Registered Public Accounting Firm on Consolidated Financial Statements</u>                      | <u>24</u> |
| <u>Consolidated Balance Sheets as of December 31, 2016 and 2015</u>                                                      | <u>25</u> |
| <u>Consolidated Statements of Operations and Comprehensive Loss for the Years ended December 31, 2016, 2015 and 2014</u> | <u>26</u> |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the Years ended December 31, 2016, 2015 and 2014</u>   | <u>27</u> |
| <u>Consolidated Statements of Cash Flows for the Years ended December 31, 2016, 2015 and 2014</u>                        | <u>28</u> |
| <u>Notes to Consolidated Financial Statements</u>                                                                        | <u>29</u> |
| <u>Schedule II – Valuation and Qualifying Accounts</u>                                                                   | <u>47</u> |

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Lawson Products, Inc.

Chicago, Illinois

We have audited the accompanying consolidated balance sheets of Lawson Products, Inc. as of December 31, 2016 and 2015 and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedule listed in the accompanying index. These consolidated financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Lawson Products, Inc. at December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated 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, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 23, 2017 expressed an unqualified opinion thereon.

/s/BDO USA, LLP

Chicago, Illinois

February 23, 2017

Lawson Products, Inc.  
Consolidated Balance Sheets

(Dollars in thousands, except share data)

|                                                                                            | December 31, |           |
|--------------------------------------------------------------------------------------------|--------------|-----------|
|                                                                                            | 2016         | 2015      |
| <b>ASSETS</b>                                                                              |              |           |
| Current assets:                                                                            |              |           |
| Cash and cash equivalents                                                                  | \$10,421     | \$10,765  |
| Restricted cash                                                                            | 800          | 800       |
| Accounts receivable, less allowance for doubtful accounts of \$454 and \$543, respectively | 30,200       | 27,231    |
| Inventories, net                                                                           | 42,561       | 44,095    |
| Miscellaneous receivables and prepaid expenses                                             | 3,788        | 3,667     |
| Total current assets                                                                       | 87,770       | 86,558    |
| Property, plant and equipment, less accumulated depreciation and amortization              | 30,907       | 35,487    |
| Cash value of life insurance                                                               | 10,051       | 10,245    |
| Goodwill                                                                                   | 5,520        | 319       |
| Deferred income taxes                                                                      | 20           | 51        |
| Other assets                                                                               | 1,039        | 434       |
| Total assets                                                                               | \$135,307    | \$133,094 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                |              |           |
| Current liabilities:                                                                       |              |           |
| Revolving line of credit                                                                   | \$841        | \$925     |
| Accounts payable                                                                           | 11,307       | 9,370     |
| Accrued expenses and other liabilities                                                     | 27,289       | 26,048    |
| Total current liabilities                                                                  | 39,437       | 36,343    |
| Security bonus plan                                                                        | 14,216       | 14,641    |
| Financing lease obligation                                                                 | 7,543        | 8,539     |
| Deferred compensation                                                                      | 4,830        | 4,626     |
| Deferred rent liability                                                                    | 3,676        | 3,912     |
| Other liabilities                                                                          | 4,472        | 3,769     |
| Total liabilities                                                                          | 74,174       | 71,830    |
| Commitments and contingencies – Note 13                                                    |              |           |
| 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 – 8,864,929 and 8,796,264 shares, respectively                                      | 8,865        | 8,796     |
| Outstanding – 8,832,623 and 8,771,120 shares, respectively                                 |              |           |
| Capital in excess of par value                                                             | 11,055       | 9,877     |
| Retained earnings                                                                          | 41,943       | 43,572    |
| Treasury stock – 32,306 and 25,144 shares held, respectively                               | (691)        | (515)     |
| Accumulated other comprehensive loss                                                       | (39)         | (466)     |
| Total stockholders' equity                                                                 | 61,133       | 61,264    |
| Total liabilities and stockholders' equity                                                 | \$135,307    | \$133,094 |

See notes to Consolidated Financial Statements

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## Lawson Products, Inc.

## Consolidated Statements of Operations and Comprehensive Loss

(Dollars in thousands, except per share data)

|                                                              | Year Ended December 31, |            |            |
|--------------------------------------------------------------|-------------------------|------------|------------|
|                                                              | 2016                    | 2015       | 2014       |
| Net sales                                                    | \$276,573               | \$275,834  | \$285,693  |
| Cost of goods sold                                           | 108,511                 | 106,710    | 113,144    |
| Gross profit                                                 | 168,062                 | 169,124    | 172,549    |
| Operating expenses:                                          |                         |            |            |
| Selling expenses                                             | 92,908                  | 90,093     | 90,776     |
| General and administrative expenses                          | 76,611                  | 75,979     | 83,350     |
| Total SG&A                                                   | 169,519                 | 166,072    | 174,126    |
| Other operating expenses, net                                | —                       | 931        | 3,386      |
| Operating expenses                                           | 169,519                 | 167,003    | 177,512    |
| Operating income (loss)                                      | (1,457 )                | 2,121      | (4,963 )   |
| Interest expense                                             | (496 )                  | (766 )     | (772 )     |
| Other income (expenses), net                                 | 422                     | (203 )     | (99 )      |
| Income (loss) from continuing operations before income taxes | (1,531 )                | 1,152      | (5,834 )   |
| Income tax expense                                           | 98                      | 855        | 227        |
| Income (loss) from continuing operations                     | (1,629 )                | 297        | (6,061 )   |
| Income and gain from discontinued operations, net of tax     | —                       | —          | 1,692      |
| Net Income (loss)                                            | \$(1,629 )              | \$297      | \$(4,369 ) |
| Basic and diluted income (loss) per share of common stock:   |                         |            |            |
| Continuing operations                                        | \$(0.19 )               | \$0.03     | \$(0.70 )  |
| Discontinued operations                                      | —                       | —          | 0.20       |
| Net income (loss)                                            | \$(0.19 )               | \$0.03     | \$(0.50 )  |
| Comprehensive loss                                           |                         |            |            |
| Net income (loss)                                            | \$(1,629 )              | \$297      | \$(4,369 ) |
| Other comprehensive loss, net of tax:                        |                         |            |            |
| Adjustment for foreign currency translation                  | 427                     | (1,892 )   | (559 )     |
| Comprehensive loss                                           | \$(1,202 )              | \$(1,595 ) | \$(4,928 ) |

See notes to Consolidated Financial Statements



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Lawson Products, Inc.

Consolidated Statements of Changes in Stockholders' Equity

(Dollars in thousands)

|                                             | Common<br>Stock,<br>\$1 par<br>value | Capital<br>in Excess<br>of Par<br>Value | Retained<br>Earnings | Treasury<br>Stock | Accumulated<br>Other<br>Comprehensive<br>income (loss) | Total<br>stockholders'<br>equity |
|---------------------------------------------|--------------------------------------|-----------------------------------------|----------------------|-------------------|--------------------------------------------------------|----------------------------------|
| Balance at January 1, 2014                  | \$ 8,671                             | \$7,799                                 | \$47,644             | \$ (187 )         | \$ 1,985                                               | \$ 65,912                        |
| Net loss                                    | —                                    | —                                       | (4,369 )             | —                 | —                                                      | (4,369 )                         |
| Adjustment for foreign currency translation | —                                    | —                                       | —                    | —                 | (559 )                                                 | (559 )                           |
| Stock-based compensation                    | —                                    | 951                                     | —                    | —                 | —                                                      | 951                              |
| Shares issued                               | 49                                   | (49 )                                   | —                    | —                 | —                                                      | —                                |
| Share repurchase under stock award program  | —                                    | —                                       | —                    | (80 )             | —                                                      | (80 )                            |
| Balance at December 31, 2014                | 8,720                                | 8,701                                   | 43,275               | (267 )            | 1,426                                                  | 61,855                           |
| Net income                                  | —                                    | —                                       | 297                  | —                 | —                                                      | 297                              |
| Adjustment for foreign currency translation | —                                    | —                                       | —                    | —                 | (1,892 )                                               | (1,892 )                         |
| Stock-based compensation                    | —                                    | 1,252                                   | —                    | —                 | —                                                      | 1,252                            |
| Shares issued                               | 76                                   | (76 )                                   | —                    | —                 | —                                                      | —                                |
| Share repurchase under stock award program  | —                                    | —                                       | —                    | (248 )            | —                                                      | (248 )                           |
| Balance at December 31, 2015                | 8,796                                | 9,877                                   | 43,572               | (515 )            | (466 )                                                 | 61,264                           |
| Net loss                                    | —                                    | —                                       | (1,629 )             | —                 | —                                                      | (1,629 )                         |
| Adjustment for foreign currency translation | —                                    | —                                       | —                    | —                 | 427                                                    | 427                              |
| Stock-based compensation                    | —                                    | 1,247                                   | —                    | —                 | —                                                      | 1,247                            |
| Shares issued                               | 69                                   | (69 )                                   | —                    | —                 | —                                                      | —                                |
| Share repurchase under stock award program  | —                                    | —                                       | —                    | (176 )            | —                                                      | (176 )                           |
| Balance at December 31, 2016                | \$ 8,865                             | \$11,055                                | \$41,943             | \$ (691 )         | \$ (39 )                                               | \$ 61,133                        |

See notes to Consolidated Financial Statements



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

|                                                                                                                 | Year Ended December 31, |            |            |
|-----------------------------------------------------------------------------------------------------------------|-------------------------|------------|------------|
|                                                                                                                 | 2016                    | 2015       | 2014       |
| Operating activities                                                                                            |                         |            |            |
| Net income (loss)                                                                                               | \$(1,629 )              | \$297      | \$(4,369 ) |
| Income from discontinued operations                                                                             | —                       | —          | (1,692 )   |
| Income (loss) from continuing operations                                                                        | (1,629 )                | 297        | (6,061 )   |
| Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities: |                         |            |            |
| Depreciation and amortization                                                                                   | 8,066                   | 8,543      | 8,751      |
| Stock-based compensation                                                                                        | 2,469                   | 2,093      | 6,376      |
| Loss on disposal of property and equipment                                                                      | 12                      | 8          | 142        |
| Deferred income taxes                                                                                           | 31                      | —          | 8          |
| Increase in environmental reserve                                                                               | —                       | 931        | 340        |
| Long-lived asset impairment                                                                                     | —                       | —          | 3,046      |
| Changes in operating assets and liabilities:                                                                    |                         |            |            |
| Accounts receivable                                                                                             | (3,252 )                | 3,285      | (2,415 )   |
| Inventories, net                                                                                                | 2,229                   | (116 )     | 882        |
| Prepaid expenses and other assets                                                                               | (45 )                   | 418        | (2,202 )   |
| Accounts payable and other liabilities                                                                          | 397                     | (6,381 )   | (7,696 )   |
| Other                                                                                                           | 182                     | 207        | 633        |
| Net cash provided by operating activities                                                                       | \$8,460                 | \$9,285    | \$1,804    |
| Investing activities                                                                                            |                         |            |            |
| Purchases of property, plant and equipment                                                                      | \$(3,112 )              | \$(2,342 ) | \$(2,759 ) |
| Business acquisitions                                                                                           | (6,030 )                | (441 )     | —          |
| Proceeds from sale of property                                                                                  | —                       | 3          | 8,307      |
| Proceeds related to the sale of businesses, net                                                                 | —                       | —          | 12,125     |
| Net cash (used in) provided by investing activities                                                             | \$(9,142 )              | \$(2,780 ) | \$17,673   |
| Financing activities                                                                                            |                         |            |            |
| Net proceeds from (payments on) revolving line of credit                                                        | \$(84 )                 | \$925      | \$(16,078) |
| Proceeds from stock option exercises                                                                            | —                       | 50         | 53         |
| Net cash provided by (used in) financing activities                                                             | \$(84 )                 | \$975      | \$(16,025) |
| Effect of exchange rate changes on cash and cash equivalents                                                    | 422                     | (922 )     | 57         |
| Increase in cash and cash equivalents                                                                           | (344 )                  | 6,558      | 3,509      |
| Cash and cash equivalents at beginning of year                                                                  | 10,765                  | 4,207      | 698        |
| Cash and cash equivalents at end of year                                                                        | \$10,421                | \$10,765   | \$4,207    |

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 government maintenance, repair and operations (“MRO”) 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 reclassifications have been made to prior period amounts to conform to the current period presentation. Such reclassifications have no effect on net income as previously reported.

**Revenue Recognition** — Net sales include product sales 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 return rates.

**Cash Equivalents** — The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The carrying amount of the Company’s cash equivalents at December 31, 2016 approximates fair value.

**Allowance for Doubtful Accounts** — 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 stated at the lower of cost or market using the first-in-first-out method. To reduce the cost basis of 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 of 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 category and product obsolescence.

**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 generally using useful lives of 20 to 30 years for buildings and improvements and 3 to 10 years for machinery and equipment, furniture and fixtures and vehicles. Amortization of financing and capital leases is included in depreciation expense. Depreciation expense was \$4.7 million, \$4.6 million and \$4.8 million for 2016, 2015 and 2014, 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 \$3.1 million, \$3.8 million and \$3.8 million for 2016, 2015 and 2014, respectively.

Cash Value of Life Insurance — The Company has invested funds in life insurance policies on certain current and former employees. The cash surrender value of the policies is invested in various investment instruments and is recorded as an asset on our consolidated financial statements. The Company records these funds at contractual value. The change in the cash surrender value of the life insurance policies, which is recorded as a component of General and administrative expenses, is the change in the policies' contractual values.

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**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 contractual value of the participants' Account Balances. These adjustments are the changes in contractual value of the individual plans and are recorded as a component of 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.

**Goodwill** — The Company had \$5.5 million and \$0.3 million of goodwill in 2016 and 2015, respectively. 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 operating decision maker responsible for reviewing operating performance and allocating resources. The Company reviews goodwill for potential impairment annually during the fourth quarter, or when an event or other circumstance changes that would more likely than not reduce the fair value of the asset below its carrying value.

The first step in the multi-step process to determine if goodwill has been impaired and to what degree is to review the relevant qualitative factors that could cause the fair value of the reporting unit to decrease below the carrying value of the reporting unit. After reviewing the qualitative factors relevant to the acquired companies, including conditions surrounding the industry we operate in compared to when the acquisitions were completed, the financial performance of the acquired companies compared to our projected results, and macroeconomic conditions as a whole, we have determined that it is more likely than not that the fair value of the reporting unit exceeds the carrying value, therefore goodwill has not been impaired and no further steps need to be taken.

**Impairment of Long-Lived Assets** — The Company reviews its long-lived assets, including property, plant and equipment and definite life 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. In 2014, in anticipation of a sale of its Reno, Nevada distribution center, the Company reviewed the future recoverability of the facility and recorded a \$3.0 million non-cash impairment charge. In 2016 the Company determined that a triggering event had occurred when it announced a plan to close its distribution center located in Fairfield, New Jersey. Based on independent offers obtained for the facility, the Company determined that no impairment had occurred.

**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 (i.e. greater than 50% likely) 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.

Primarily due to the cumulative losses incurred in recent years, management determined that it was more likely than not that it would not be able to utilize deferred tax assets to offset future taxable income and increased the deferred tax valuation allowance to equal substantially all of the Company's net deferred tax assets. A tax valuation allowance will remain until the Company can establish that the recoverability of its deferred tax assets is more certain.

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

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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 shorter of the estimated useful life of the asset or the lease term.

For build-to-suit financing 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. If a lease does not meet the criteria to qualify for a sale-leaseback transaction, the established asset and liability remain on the Company's consolidated balance sheet. This asset is depreciated over the life of the lease and the liability is reduced by the non-interest portion of the lease payments for costs allocated to the building and on a straight line basis for costs allocated to land.

**Sub-leases** — If the Company is relieved of its primary obligation under the original lease then the original lease is considered to be terminated, otherwise if the Company retains primary obligation under the original lease then the Company continues to account for the original lease and also accounts for the new sub-lease as lessor. At the time the sub-lease is executed, the Company records a gain or loss equal to the difference between the total cash payments to be made for gross rent under the original lease agreement over the life of the sub-lease plus executory costs and total gross rent proceeds expected to be received over the life of the sub-lease.

**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 are translated into U.S. dollars using the exchange rates in effect at the applicable period end. Components of income or loss are translated using the average exchange rate for each reporting period.

Gains and losses resulting from changes in the exchange rates from translation of the subsidiary accounts in local currency to U.S. dollars are reported as a component of Accumulated other comprehensive loss in the consolidated balance sheets. Gains and losses resulting from the effect of exchange rate changes on transactions denominated in currencies other than the functional currency are included as a component of net income or loss upon settlement of the transaction.

Gains and losses resulting from intercompany transactions are included as a component of net income or loss each reporting period unless the transactions are of a long-term-investment nature and settlement is not planned or anticipated in the foreseeable future, in which case the gains and losses are recorded as a component of Accumulated other comprehensive loss in the consolidated balance sheets.

**Treasury Stock** — The Company repurchased 7,162, 11,261 and 2,256 shares of its common stock in 2016, 2015 and 2014, 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. The value of the treasury stock repurchased of \$0.2 million, \$0.2 million and \$0.1 million in 2016, 2015 and 2014, respectively, was acquired in a non-cash transaction that is not included in the consolidated statements of cash flows.

Acquisitions — The Company recognizes identifiable assets acquired and liabilities assumed at their acquisition date fair values. Goodwill as of the acquisition date is measured as the excess of consideration transferred over the net of the acquisition date fair values of the assets acquired and the liabilities assumed. While the Company uses its best estimates and assumptions for the purchase price allocation process to value assets acquired and liabilities assumed at the acquisition date, the estimates are inherently uncertain and subject to refinement. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed, with the corresponding offset to goodwill.

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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 for allowance for doubtful accounts, inventory reserves and income taxes in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

### Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-04, Simplifying the Test for Goodwill Impairment. This standard eliminates a step from the goodwill impairment test and instead requires an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit’s fair value. This guidance is effective for interim and annual goodwill impairment tests in fiscal years beginning after December 15, 2019, and early adoption is permitted. This guidance must be applied on a prospective basis. We expect to adopt this guidance for interim and annual goodwill impairment tests performed on testing dates after January 1, 2017. We do not expect the adoption of this guidance to have a material impact on our financial position, results of operations or cash flows.

In November 2016, the FASB issued ASU 2016-18, Restricted Cash, which requires amounts generally described as restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the total beginning and ending amounts for the periods shown on the statement of cash flows. ASU 2016-08 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a retrospective transition method to each period presented. The Company does not expect the impact on its consolidated financial statements to be material.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which amends ASC Topic 718, Compensation – Stock Compensation. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. The Company will adopt ASU 2016-09 in the first quarter of 2017. The Company does not expect the adoption of the ASU to have a material impact on net income, basic and diluted earnings per share.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018 (including interim periods within those periods) using a modified retrospective approach and early adoption is permitted. The Company will adopt ASU 2016-02 in the first quarter of 2019. While the effect of the pronouncement has not yet been quantified, the Company is continuing to evaluate the impact of recording the right-of-use-assets and liabilities on its financial position.

In November, 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes. This update simplifies the presentation of deferred income taxes by requiring all entities that present a classified balance sheet to classify all deferred tax assets and liabilities as a noncurrent amount. The FASB feels that this simplification will reduce the cost and complexity of recording deferred taxes without affecting the usefulness of financial statement information. This pronouncement will be effective for public entities in fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted. The guidance may be applied on either a prospective or retrospective basis. The Company will adopt ASU 2015-07 on a prospective basis in 2017 and,

due to the full valuation allowance for deferred taxes, does not expect adoption to have a material impact on its financial position.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory, which requires an entity to measure inventory at the lower of cost or net realizable value, which consists of the estimated selling prices in the ordinary course of business, less reasonably predictable cost of completion, disposal, and transportation. This pronouncement is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those fiscal years. The guidance is to be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company does not expect adoption of ASU 2015-11 to have a material impact on its financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing

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U.S. GAAP. The new standard is effective for the Company's interim and annual periods beginning with the first quarter of 2018. The standard is to be applied using one of two retrospective application methods, with early application not permitted. The Company is in the initial stages of evaluating the effect of the standard on its financial statements and is currently determining the impact of the pronouncement on the consolidated financial statements and the method by which the standard will be adopted.

## Note 3 — Restricted Cash

The Company has agreed to maintain \$0.8 million in a money market account as collateral for an outside party that is providing certain commercial card processing services for the Company. The Company is restricted from withdrawing this balance without the prior consent of the outside party during the term of the agreement.

## Note 4 – Inventories, net

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

|                                           | (Dollars in<br>thousands) |          |
|-------------------------------------------|---------------------------|----------|
|                                           | December 31,              |          |
|                                           | 2016                      | 2015     |
| Inventories, gross                        | \$48,038                  | \$49,615 |
| Reserve for obsolete and excess inventory | (5,477 )                  | (5,520 ) |
| Inventories, net                          | \$42,561                  | \$44,095 |

## Note 5 - Property, Plant and Equipment

Components of property, plant and equipment were as follows:

|                                           | (Dollars in<br>thousands) |           |
|-------------------------------------------|---------------------------|-----------|
|                                           | December 31,              |           |
|                                           | 2016                      | 2015      |
| Land                                      | \$2,721                   | \$2,692   |
| Buildings and improvements                | 18,981                    | 18,343    |
| Machinery and equipment                   | 22,837                    | 22,558    |
| Capitalized software                      | 21,371                    | 19,710    |
| McCook Facility                           | 12,961                    | 12,961    |
| Furniture and fixtures                    | 5,714                     | 5,693     |
| Capital leases                            | 534                       | 563       |
| Vehicles                                  | 166                       | 163       |
| Construction in progress                  | 571                       | 681       |
|                                           | 85,856                    | 83,364    |
| Accumulated depreciation and amortization | (54,949 )                 | (47,877 ) |
|                                           | \$30,907                  | \$35,487  |

## Note 6 - Acquisitions

Primarily to expand its sales coverage and retain experienced sales representatives, the Company completed three acquisitions in 2016. In November, the Company acquired the assets of Mattic Industries Limited ("Mattic") an industrial parts distributor located in western Canada, for approximately \$3.5 million in cash and \$0.3 million in contingent consideration. In May, the Company acquired the assets of F.B. Feeney Hardware ("F. B. Feeney") in Ontario, Canada, for approximately \$1.3 million in cash and \$0.1 million in contingent consideration. And, in March, the Company acquired the assets of Perfect Products Company of Michigan ("Perfect Products"), an auto parts distributor for approximately \$1.3 million in cash and \$30 thousand in contingent consideration.

The Company allocated \$0.7 million of the purchase price of the three acquisitions to an intangible asset for customer relationships which was included in Other assets in the Condensed Consolidated Balance Sheets which will be amortized over five years. Total contingent consideration of \$0.4 million was not reflected in the condensed consolidated statement of cash flows.

The Company acquired one Company in 2015, West Coast Fasteners LTD (West Coast"), an auto parts distributor located in western Canada for approximately \$0.4 million in cash.

A summary of the purchase price allocation of the acquisitions is as follows:

|                                   | (Dollars in thousands) |       |
|-----------------------------------|------------------------|-------|
|                                   | December               |       |
|                                   | 31,                    |       |
|                                   | 2016                   | 2015  |
| Cash paid and liabilities assumed |                        |       |
| Cash paid                         | 6,030                  | 441   |
| Contingent consideration          | 412                    | —     |
| Other liabilities                 | 188                    | —     |
|                                   | \$6,630                | \$441 |
| Fair value of assets acquired     |                        |       |
| Goodwill                          | \$5,231                | \$299 |
| Customer relationships            | 733                    | —     |
| Inventory                         | 584                    | 137   |
| Other assets                      | 82                     | 5     |
|                                   | \$6,630                | \$441 |

The following table contains unaudited pro forma net sales and net loss for Lawson Products assuming the Mattic, F.B Feeney and Perfect Product acquisitions closed on January 1, 2015 and the West Coast acquisition closed on January 1, 2014.

| (Dollars in thousands)  |           |           |           |
|-------------------------|-----------|-----------|-----------|
| Year Ended December 31, |           |           |           |
|                         | 2016      | 2015      | 2014      |
| Net Sales               | \$280,445 | \$283,575 | \$286,552 |
| Net income (loss)       | (848 )    | 317       | (4,643 )  |

The pro forma disclosures in the table above include adjustments for, amortization of intangible assets and acquisition costs to reflect results that are more representative of the combined results of the transactions as if the Mattic, F.B Feeney and Perfect Product acquisitions closed on January 1, 2015 and the West Coast acquisition closed on January 1, 2014. This pro forma information utilizes certain estimates, is presented for illustrative purposes only and may not be indicative of the results of operation that would have actually occurred. In addition, future results may vary significantly from the results reflected in the pro forma information. The unaudited pro forma financial information does not reflect the impact of future events that may occur after the acquisition, such as anticipated cost savings from operating synergies.

#### Note 7 - Goodwill

Goodwill activity related to these acquisitions is included in the table below:

| (Dollars in thousands)     |         |       |
|----------------------------|---------|-------|
| December 31,               |         |       |
|                            | 2016    | 2015  |
| Beginning balance          | \$319   | \$—   |
| Acquisitions               | 5,231   | 299   |
| Impact of foreign exchange | (30 )   | 20    |
| Ending balance             | \$5,520 | \$319 |

Goodwill was tested for impairment in the fourth quarter of 2016 and no adjustment was deemed necessary.

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## Note 8 – Income Taxes

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

|               | (Dollars in thousands)  |          |           |
|---------------|-------------------------|----------|-----------|
|               | Year Ended December 31, |          |           |
|               | 2016                    | 2015     | 2014      |
| United States | \$(708 )                | \$3,583  | \$(4,355) |
| Canada        | (823 )                  | (2,431 ) | (1,479 )  |
|               | \$(1,531)               | \$1,152  | \$(5,834) |

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

|                                       | (Dollars in thousands) |         |         |
|---------------------------------------|------------------------|---------|---------|
|                                       | Year Ended             |         |         |
|                                       | December 31,           |         |         |
|                                       | 2016                   | 2015    | 2014    |
| Current income tax expense (benefit): |                        |         |         |
| U.S. Federal                          | \$97                   | \$(461) | \$(377) |
| U.S. state                            | (33 )                  | 75      | 79      |
| Canada                                | 3                      | 1,241   | 525     |
| Total                                 | \$67                   | \$855   | \$227   |
| Deferred income tax expense:          |                        |         |         |
| U.S. Federal                          | —                      | —       | —       |
| U.S. state                            | 31                     | —       | —       |
| Canada                                | —                      | —       | —       |
| Total                                 | 31                     | —       | —       |
| Total income tax expense (benefit):   |                        |         |         |
| U.S. Federal                          | 97                     | (461 )  | (377 )  |
| U.S. state                            | (2 )                   | 75      | 79      |
| Canada                                | 3                      | 1,241   | 525     |
| Total                                 | 98                     | 855     | 227     |

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

|                                     | Year Ended December 31, |        |         |
|-------------------------------------|-------------------------|--------|---------|
|                                     | 2016                    | 2015   | 2014    |
| Statutory Federal rate              | 35.0%                   | 35.0 % | 35.0%   |
| Increase (decrease) resulting from: |                         |        |         |
| State and local taxes, net          | (17.4 )                 | 10.4   | 2.8     |
| Change in valuation allowance       | 14.5                    | (86.4) | (26.9 ) |
| Foreign tax rate differential       | (14.3 )                 | 17.9   | (2.2 )  |
| Meals & entertainment               | (9.0 )                  | 11.6   | (2.6 )  |
| Alternative minimum tax             | (6.3 )                  | 7.6    | —       |
| Provision to return differences     | (4.5 )                  | 24.4   | (3.2 )  |
| Executive life insurance            | (3.1 )                  | 2.4    | 2.3     |
| Captive insurance income            | (3.0 )                  | —      | —       |
| Change in uncertain tax positions   | 0.6                     | 56.2   | (9.0 )  |
| Other items, net                    | 1.1                     | (4.9 ) | (0.1 )  |
| Provision for income taxes          | (6.4 )%                 | 74.2 % | (3.9 )% |

The Company paid income taxes of \$0.2 million, \$0.1 million and \$0.2 million in the years ended December 31, 2016, 2015, and 2014, respectively. At December 31, 2016, the Company had \$46.7 million of U.S. Federal net operating loss carryforwards which are subject to expiration beginning in 2030, and \$0.5 million of foreign tax credit carryforwards which are subject to expiration beginning in 2020. In addition, the Company had \$37.5 million of various state net operating loss carryforwards which expire at varying dates through 2034.

Primarily due to the cumulative losses incurred in recent years, management determined that it was more likely than not that the Company will not be able to utilize its deferred tax assets to offset future taxable income. In 2016, 2015 and 2014 the Company decreased its deferred tax valuation allowance by \$1.1 million, \$0.2 million and \$0.8 million, respectively. The tax valuation allowance will remain until the Company can establish that the recoverability of its deferred tax assets is more likely than not. As a result of acquisitions completed in 2016 and 2015, the Company recorded \$5.5 million of tax deductible goodwill that may result in a tax benefit in future periods.

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

|                                 | (Dollars in thousands) |          |
|---------------------------------|------------------------|----------|
|                                 | December 31,           |          |
|                                 | 2016                   | 2015     |
| Deferred tax assets:            |                        |          |
| Net operating loss carryforward | \$17,518               | \$19,336 |
| Compensation and benefits       | 12,126                 | 11,979   |
| Inventory reserve               | 2,750                  | 2,726    |
| Capital loss carryforward       | 2,210                  | 2,210    |
| Accounts receivable reserve     | 183                    | 218      |
| Other                           | 1,770                  | 2,073    |
| Total deferred tax assets       | 36,557                 | 38,542   |
| Deferred tax liabilities:       |                        |          |
| Property, plant and equipment   | 433                    | 1,100    |
| Other                           | 688                    | 875      |
| Total deferred liabilities      | 1,121                  | 1,975    |

|                                                    |           |           |
|----------------------------------------------------|-----------|-----------|
| Net deferred tax assets before valuation allowance | 35,436    | 36,567    |
| Valuation allowance                                | (35,416 ) | (36,516 ) |
| Net deferred tax assets                            | \$20      | \$51      |

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

|                                             | (Dollars in thousands) |         |
|---------------------------------------------|------------------------|---------|
|                                             | December 31,           |         |
|                                             | 2016                   | 2015    |
| Balance at beginning of year                | \$3,136                | \$2,964 |
| Additions for tax positions of current year | 544                    | 146     |
| Additions for tax positions of prior years  | 116                    | 26      |
| Reductions for tax positions of prior year  | (547)                  | —       |
| Balance at end of year                      | \$3,249                | \$3,136 |

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, 2016 balance of unrecognized tax benefits represent tax positions that could significantly change during the next twelve months. Interest and penalties related to unrecognized tax benefits are recorded as a component of income tax expense.

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, 2016, the Company was subject to U.S Federal income tax examinations for the years 2013 through 2015 and income tax examinations from various other jurisdictions for the years 2011 through 2015.

The Company was subject to an examination by the Canada Revenue Authority ("CRA") for the years 2006 through 2010. The CRA examination was completed during May 2013 and resulted in proposed adjustments which amount to \$1.3 million of additional tax for the 2008 and 2009 tax years. The Company did not agree with these adjustments and filed a request with Competent Authority programs in both the U.S. and Canada in October, 2013. The Competent Authority program assists taxpayers with respect to matters covered in the mutual agreement procedure provisions of tax treaties. In the fourth quarter of 2015, Competent Authority completed their review and communicated to the Company that they proposed to assess a tax on the 2009 tax year only. A formal Letter of Disposition from Competent Authority was received in April 2016. The Company has accepted the proposal and recorded an expense in 2015 of approximately \$0.8 million in Canada and a related benefit of \$0.5 million in the U.S.

#### Note 9 - Accrued Expenses and Other Liabilities

Accrued expenses and other liabilities consisted of the following:

|                                                     | (Dollars in thousands) |         |
|-----------------------------------------------------|------------------------|---------|
|                                                     | December 31,           |         |
|                                                     | 2016                   | 2015    |
| Accrued stock-based compensation                    | \$7,859                | \$6,980 |
| Accrued compensation                                | 5,465                  | 6,289   |
| Accrued severance                                   | 1,428                  | 697     |
| Accrued and withheld taxes, other than income taxes | 1,149                  | 1,199   |
| Financing lease obligation                          | 996                    | 876     |
| Reserve for unrecognized tax benefits               | 760                    | 738     |
| Accrued health benefits                             | 676                    | 700     |
| Accrued profit sharing                              | 627                    | 774     |

Other

|          |          |
|----------|----------|
| 8,329    | 7,795    |
| \$27,289 | \$26,048 |

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## Note 10 – Loan Agreement

In 2012, the Company entered into a Loan and Security Agreement (“Loan Agreement”) with The PrivateBank and Trust Company. The Loan Agreement consists of a \$40.0 million revolving line of credit facility, which includes a \$10.0 million sub-facility for letters of credit. Certain terms of the original Loan Agreement were revised in December 2013 and in September 2016. The Loan Agreement, as amended, expires in August 2020. Due to the lock box arrangement and a subjective acceleration clause contained in the Loan Agreement, any outstanding borrowings under the revolving line of credit are classified as a current liability.

Credit available under the Loan Agreement is based upon:

- a) 85% of the face amount of the Company’s eligible accounts receivable, generally less than 60 days past due, and
- b) the lesser of 60% of the lower of cost or market value of the Company’s eligible inventory, generally inventory expected to be sold within 18 months, or \$20.0 million.

The applicable interest rates for borrowings are the Prime rate or, if the Company elects, the LIBOR rate plus 1.50% to 1.85% based on the Company’s debt to EBITDA ratio, as defined in the amended Loan Agreement. The Loan Agreement is secured by a first priority perfected security interest in substantially all existing assets of the Company. Dividends are restricted so as not to exceed \$7.0 million annually.

At December 31, 2016, the Company had \$0.8 million outstanding balance under its revolving line of credit facility and additional borrowing availability of \$35.0 million. The carrying amount of the Company’s debt at December 31, 2016 approximates its fair value. The Company paid interest of \$0.2 million, \$0.5 million and \$0.8 million in 2016, 2015 and 2014, respectively. The weighted average interest rate was 3.5% in 2016. The Company had \$1.5 million of outstanding letters of credit as of December 31, 2016.

In addition to other customary representations, warranties and covenants, and if the excess capacity is below \$10.0 million, the Company is required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement, and a minimum quarterly tangible net worth level as defined in the amended Loan Agreement. On December 31, 2016, the Company's borrowing capacity exceeded \$10.0 million, therefore, the Company was not subject to these financial covenants, however, for informational purposes the results of the financial covenants are provided below:

| Quarterly Financial Covenants | Requirement    | Actual         |
|-------------------------------|----------------|----------------|
| EBITDA to fixed charges ratio | 1.10 : 1.00    | 1.75 : 1.00    |
| Minimum tangible net worth    | \$45.0 million | \$48.6 million |

## Note 11 – Reserve for Severance

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

|                     | (Dollars in thousands)  |        |          |
|---------------------|-------------------------|--------|----------|
|                     | Year Ended December 31, |        |          |
|                     | 2016                    | 2015   | 2014     |
| Beginning balance   | \$697                   | \$311  | \$1,769  |
| Charged to earnings | 2,376                   | 1,273  | 631      |
| Cash paid           | (1,363 )                | (887 ) | (2,089 ) |

Ending balance      \$1,710   \$697   \$311

The remaining severance liabilities outstanding as of December 31, 2016 will substantially be paid by the end of 2017.

## Note 12 - Retirement and Security Bonus Plans

The Company provides a 401(k) defined contribution plan to allow employees a pre-tax investment vehicle to save for retirement. The Company made contributions to the 401(k) plan of \$3.1 million, \$2.9 million and \$2.9 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company provides a profit sharing plan 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 \$0.6 million, \$0.8 million and \$0.6 million for the years ended December 31, 2016, 2015 and 2014, respectively.

The Company has a security bonus plan which was previously created for the benefit of its independent sales representatives, under the terms of which participants are credited with a percentage of their annual 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. On January 1, 2013, the Company converted all of its U.S. independent sales representatives to employees. The security bonus for those converted employees continue to vest, but their accounts are no longer credited with a percentage of net commissions. For financial reporting purposes, amounts are charged to operations over the vesting period. Expenses incurred for the security bonus plan were \$0.4 million, \$0.4 million and \$0.6 million for the years ended December 31, 2016, 2015 and 2014, respectively. The security bonus plan is partially funded by a \$3.3 million investment in the cash surrender value in life insurance of certain employees.

## Note 13 - Commitments and Contingencies

## Lease Commitments

Total rental expense for the years ended December 31, 2016, 2015 and 2014 amounted to \$2.2 million, \$2.0 million and \$1.8 million, respectively. Of the \$12.8 million future minimum operating lease commitments outstanding at December 31, 2016, \$7.5 million relates to a lease for the Company's headquarters which expires in March 2023. The lease commitment is partially offset by a portion of the headquarters that has been sub-leased through March 2023 and includes total future minimum lease proceeds of \$0.6 million.

The Company has a financing lease for the McCook Facility which expires in June 2022 and includes future minimum lease payments, related to the building, of \$7.5 million.

The Company's future minimum lease commitments, principally for facilities and equipment, as of December 31, 2016, were as follows:

| Year ended December 31, | (Dollars in thousands) |                    |                   |
|-------------------------|------------------------|--------------------|-------------------|
|                         | Operating<br>Leases    | Financing<br>Lease | Capital<br>Leases |
| 2017                    | \$1,896                | \$ 1,255           | \$ 124            |
| 2018                    | 1,884                  | 1,348              | 96                |
| 2019                    | 1,852                  | 1,395              | 39                |
| 2020                    | 1,909                  | 1,443              | —                 |
| 2021                    | 1,967                  | 1,493              | —                 |
| Thereafter              | 3,248                  | 542                | —                 |
| Total                   | \$12,756               | \$ 7,476           | \$ 259            |

At December 31, 2016, the cost and accumulated depreciation of the asset related to the financing lease were \$13.0 million and \$5.9 million, respectively, and the cost and accumulated amortization of the assets related to capital leases

were \$0.5 million and \$0.3 million, respectively.

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### 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.

### Environmental matter

In 2012, the Company identified that a site it owns in Decatur, Alabama contains hazardous substances in the soil and groundwater as a result of historical operations prior to the Company's ownership. The Company retained an environmental consulting firm to further investigate the contamination including the measurement and monitoring of the site. In August 2013, the site was enrolled in Alabama's voluntary cleanup program. On October 30, 2014, the Company received estimates from its environmental consulting firm with three potential remediation solutions. The estimates include a range of viable remedial approaches. The first solution included limited excavation and removal of the contaminated soil along with monitoring for a period up to 10 years. The second solution included the first solution plus the installation of a groundwater extraction system. The third scenario included the first and second solutions plus treatment injections to reduce the degradation time. The estimated expenditures over a 10-year period under the three scenarios ranged from \$0.3 million to \$1.4 million, of which up to \$0.3 million may qualify to be capitalized. As the Company had determined that a loss was probable; however, no scenario was more likely than the other at this time, a liability in the amount of \$0.3 million was established in 2014.

During 2015, after further evidence had been collected and analyzed, the Company concluded that it was probable that future remediation would be required, and accordingly accrued an additional \$0.9 million for the estimated costs. This estimate is based on the information developed to date and as the remediation efforts proceed, additional information may impact the final cost. As of December 31, 2016, agreement with Alabama's voluntary cleanup program on viable treatment of the property has not yet been reached and the Company continues to evaluate potential remediation alternatives that could impact the ultimate cost of remediation. As of December 31, 2016, approximately \$1.1 million is accrued for remediation in other long-term liabilities on the accompanying consolidated balance sheet.

### Tax matter

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

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

### Note 14 – Stock-Based Compensation Plans

#### Plan Administration

The Company's Amended and Restated 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. As of December 31, 2016, the Company had approximately 415,000 shares of common stock still available under the Equity Plan with no participant allowed a grant of 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 also has a Stock Performance Rights Plan ("SPR Plan") that provides for the issuance of Stock Performance Rights ("SPRs") that allow non-employee directors, officers and key employees to receive cash awards, subject to certain

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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.

## Stock Performance Rights

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 date of grant and remeasured each reporting period, is recorded ratably over the vesting period. Compensation expense or benefit is included in General and administrative expense. A majority of the outstanding SPRs have a seven to ten year life and vest over one to three years beginning on the first anniversary of the date of the grant.

On December 31, 2016, 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, 2016 was \$9.66 per SPR using the following assumptions:

|                          |                   |
|--------------------------|-------------------|
| Expected volatility      | 35.7% to<br>44.5% |
| Risk-free rate of return | 0.1% to<br>1.8%   |
| Expected term (in years) | 0.2 to 4.5        |
| Expected annual dividend | \$0               |

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.

Compensation expense of \$1.2 million, \$0.9 million and \$5.5 million was recorded for the years ended December 31, 2016, 2015 and 2014, respectively. Cash in the amount of \$0.3 million and \$1.0 million was paid out for SPR exercises in 2016 and 2015, respectively, and an immaterial amount of cash was paid out in 2014. A liability of \$7.9 million reflecting the estimated fair value of future pay-outs has been included as a component of Accrued expenses on the consolidated balance sheets.

Activity related to the Company's SPRs during the year ended December 31, 2016 was as follows:

|                                  | Number    | Weighted<br>Average<br>Exercise<br>Price |
|----------------------------------|-----------|------------------------------------------|
| Outstanding on December 31, 2015 | 959,499   | \$ 19.91                                 |
| Granted                          | 53,502    | 18.98                                    |
| Exercised                        | (41,300 ) | 11.17                                    |
| Cancelled                        | (25,000 ) | 44.02                                    |
| Outstanding on December 31, 2016 | 946,701   | 19.60                                    |

Exercisable on December 31, 2016 614,301 \$ 15.81

The SPRs outstanding had an intrinsic value of \$6.2 million as of December 31, 2016. Unrecognized compensation cost related to non-vested SPRs was \$0.8 million at December 31, 2016, which will be recognized over a weighted average period of 1.2 years. During the year ended December 31, 2016, 217,876 SPRs with a fair value of \$1.8 million vested. At December 31, 2016, the weighted average remaining contractual term was 4.7 years for all outstanding SPRs and 4.4 years for all exercisable SPRs.

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## Restricted Stock Awards

Restricted stock awards ("RSAs") generally vest over a one to three year period beginning on the first anniversary of the date of the grant. Upon vesting, the vested restricted stock awards are exchanged for an equal number of the Company's common stock. The participants have no voting or dividend rights with the restricted stock awards. 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.

Compensation expense of \$0.6 million, \$0.6 million and \$0.5 million related to the RSAs was recorded in General and administrative expenses for 2016, 2015 and 2014, respectively. Activity related to the Company's RSAs during the year ended December 31, 2016 was as follows:

|                                  | Restricted<br>Stock<br>Awards |
|----------------------------------|-------------------------------|
| Outstanding on December 31, 2015 | 30,985                        |
| Granted                          | 28,567                        |
| Exchanged for shares             | (27,655 )                     |
| Outstanding on December 31, 2016 | 31,897                        |

As of December 31, 2016, there was \$0.2 million of total unrecognized compensation cost related to RSAs that will be recognized over a weighted average period of four months. The awards granted in 2016 had a weighted average grant date fair value of \$18.38 per share.

## Market Stock Units

Market Stock Units ("MSUs") are exchangeable for between 0% to 150% of the Company's common shares at the end of the vesting period based on the trailing 30 or 60 day average closing price of the Company's common stock. The value of the MSUs was determined using a geometric brownian motion model that, based on certain variables, generates a large number of random trials simulating the price of the common stock over the measurement period. Expense of \$0.5 million, \$0.5 million and \$0.3 million related to MSUs was recorded in the years ended December 31, 2016, 2015 and 2014, respectively. Activity related to the Company's MSUs during the year ended December 31, 2016 was as follows:

|                                  | Number<br>of<br>Market<br>Stock<br>Units | Maximum<br>Shares<br>Potentially<br>Issuable |
|----------------------------------|------------------------------------------|----------------------------------------------|
| Outstanding on December 31, 2015 | 87,770                                   | 131,655                                      |
| Granted                          | 74,865                                   | 112,299                                      |
| Exchanged for shares             | (13,103 )                                | (19,656 )                                    |
| Outstanding on December 31, 2016 | 149,532                                  | 224,298                                      |

## Stock Options

Each stock option can be exchanged for one share of the Company's common stock. As of December 31, 2016 the Company had 45,910 stock options outstanding with a weighted average exercise price of \$26.55. Expense related to stock options was \$0.1 million in 2016 and unrecognized compensation at December 31, 2016 was \$0.1 million.

#### Stock Awards

As of December 31, 2016, the Company had 40,000 stock awards outstanding which entitle the holder to receive shares of the Company's common stock equal in value to the appreciation in the Company's common stock from the exercise price of \$10.00 up to the date the holder exercises the award. The stock awards vested on December 31, 2014 and expire on October 2, 2017. During 2016, 38,000 stock awards were exercised resulting in the issuance of 21,089 common shares.

## Note 15 — Discontinued operations

On February 14, 2014, the Company completed the sale of substantially all of the assets of Automatic Screw Machine Products Company, Inc. ("ASMP"), a wholly-owned subsidiary, to Nelson Stud Welding, Inc. ("Buyer"), an indirect subsidiary of Doncasters Group Limited, for a purchase price of \$12.5 million plus the assumption of certain liabilities. In addition, the Buyer agreed to lease the real property located in Decatur, Alabama, where ASMP was located. The Company classified ASMP's operating results as discontinued operations for all periods presented.

The following table details the components of income from discontinued operations:

|                                                          | (Dollars in thousands) |         |
|----------------------------------------------------------|------------------------|---------|
|                                                          | Year Ended             |         |
|                                                          | December 31,           |         |
|                                                          | 2015                   | 2014    |
| Net sales                                                | \$—                    | \$2,462 |
| Total pre-tax income                                     | —                      | 346     |
| Income tax expense                                       | —                      | 133     |
| Net income                                               | \$—                    | \$213   |
| Sale of discontinued operations                          |                        |         |
| Pre-tax gain on sale                                     | \$—                    | \$1,877 |
| Income tax expense                                       | —                      | 398     |
| Net gain on sale                                         | \$—                    | \$1,479 |
| Income and gain from discontinued operations, net of tax | \$—                    | \$1,692 |
| Basic and diluted income per share                       | \$—                    | \$0.20  |

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## Note 16 - Other Operating Expenses, Net

Other operating expenses, net consisted of the following:

|                                     | (Dollars in thousands) |       |         |
|-------------------------------------|------------------------|-------|---------|
|                                     | Year Ended             |       |         |
|                                     | December 31,           |       |         |
|                                     | 2016                   | 2015  | 2014    |
| Environmental remediation expense   | \$—                    | \$931 | \$340   |
| Impairment loss                     | —                      | —     | 3,046   |
| Total other operating expenses, net | \$—                    | \$931 | \$3,386 |

## Environmental remediation matter

In 2015 and 2014, the Company accrued \$0.9 million and \$0.3 million, respectively, related to estimated future remediation of an environmental matter involving land owned in Decatur, Alabama, that was part of a division that was previously sold in 2014. Refer to "Environmental Matter" in Note 12 for further details.

## Impairment loss

In 2014, the Company completed the sale of its Reno, Nevada, distribution center. As part of the review of the impact of a sale, the Company determined that the full carrying amount of the asset was not recoverable. Therefore, the Company recorded a \$3.0 million non-cash impairment charge prior to the sale. The Company entered into an agreement to leaseback approximately one-half of the building for a 10-year term.

## Note 17 – Earnings (Loss) Per Share

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

|                                                              | (Dollars in thousands, except per share data) |        |           |
|--------------------------------------------------------------|-----------------------------------------------|--------|-----------|
|                                                              | Year Ended December                           |        |           |
|                                                              | 31,                                           |        |           |
|                                                              | 2016                                          | 2015   | 2014      |
| Weighted average shares:                                     |                                               |        |           |
| Basic weighted average shares outstanding                    | 8,780                                         | 8,726  | 8,683     |
| Effect of dilutive securities outstanding                    | —                                             | 150    | —         |
| Diluted weighted average shares outstanding                  | 8,780                                         | 8,876  | 8,683     |
| Earnings (loss):                                             |                                               |        |           |
| Continuing operations                                        | \$(1,629)                                     | \$297  | \$(6,061) |
| Discontinued operations                                      | —                                             | —      | 1,692     |
| Net earnings (loss)                                          | \$(1,629)                                     | \$297  | \$(4,369) |
| Basic and diluted earnings (loss) per share of common stock: |                                               |        |           |
| Continuing operations                                        | \$(0.19 )                                     | \$0.03 | \$(0.70 ) |
| Discontinued operations                                      | —                                             | —      | 0.20      |
| Net earnings (loss)                                          | \$(0.19 )                                     | \$0.03 | \$(0.50 ) |

For the year ended December 31, 2016 and 2015, stock options to purchase 40,000 of the Company's common stock were excluded from the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common stock. The dilutive effect of outstanding securities of approximately 164,000 and 146,000 for the years ended December 31, 2016 and 2014, respectively, were excluded from the computation of diluted earnings per share as the Company recorded a loss for those periods and therefore the effect would have been anti-dilutive.

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## Note 18 – Geographic Information

Financial information related to the Company's continuing operations by geographic area follows:

|                          | (Dollars in thousands)  |           |           |
|--------------------------|-------------------------|-----------|-----------|
|                          | Year Ended December 31, |           |           |
|                          | 2016                    | 2015      | 2014      |
| Net sales <sup>(1)</sup> |                         |           |           |
| United States            | \$250,824               | \$251,129 | \$257,428 |
| Canada                   | 25,749                  | 24,705    | 28,265    |
| Consolidated total       | \$276,573               | \$275,834 | \$285,693 |

|                                  |          |          |          |
|----------------------------------|----------|----------|----------|
| Long-lived assets <sup>(2)</sup> |          |          |          |
| United States                    | \$30,041 | \$33,813 | \$39,681 |
| Canada                           | 7,425    | 2,427    | 2,417    |
| Consolidated total               | \$37,466 | \$36,240 | \$42,098 |

(1) Net sales are attributed to countries based on the location of customers.

(2) Long-lived assets primarily consist of property, plant and equipment, goodwill and intangible assets.

## Note 19 - Summary of Unaudited Quarterly Results of Operations

Unaudited quarterly results of operations for the years ended December 31, 2016 and 2015 are summarized below:

|                                                                | (Dollars in thousands, except per share data) |          |          |          |
|----------------------------------------------------------------|-----------------------------------------------|----------|----------|----------|
|                                                                | 2016 Quarter Ended                            |          |          |          |
|                                                                | Dec. 31                                       | Sep. 30  | Jun. 30  | Mar. 31  |
| Net sales                                                      | \$67,315                                      | \$70,199 | \$69,348 | \$69,711 |
| Gross profit                                                   | \$40,504                                      | \$42,573 | \$42,526 | \$42,459 |
| Net income (loss)                                              | \$(4,643 )                                    | \$1,825  | \$172    | \$1,017  |
| Basic income (loss) per share of common stock <sup>(1)</sup>   | \$(0.53 )                                     | \$0.21   | \$0.02   | \$0.12   |
| Diluted income (loss) per share of common stock <sup>(1)</sup> | \$(0.53 )                                     | \$0.20   | \$0.02   | \$0.11   |

|                                                                | (Dollars in thousands, except per share data) |          |          |            |
|----------------------------------------------------------------|-----------------------------------------------|----------|----------|------------|
|                                                                | 2015 Quarter Ended                            |          |          |            |
|                                                                | Dec. 31                                       | Sep. 30  | Jun. 30  | Mar. 31    |
| Net sales                                                      | \$64,961                                      | \$70,243 | \$70,726 | \$69,904   |
| Gross profit                                                   | \$39,091                                      | \$43,342 | \$43,808 | \$42,883   |
| Net income (loss)                                              | \$(3,688 )                                    | \$2,430  | \$2,926  | \$(1,371 ) |
| Basic income (loss) per share of common stock <sup>(1)</sup>   | \$(0.42 )                                     | \$0.28   | \$0.34   | \$(0.16 )  |
| Diluted income (loss) per share of common stock <sup>(1)</sup> | \$(0.42 )                                     | \$0.27   | \$0.33   | \$(0.16 )  |

(1) 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.

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Lawson Products, Inc.

## Schedule II -Valuation and Qualifying Accounts

The roll forward of valuation accounts were as follows:

| Description                                  | (Dollars in thousands)                     |                                        |            |                                   |
|----------------------------------------------|--------------------------------------------|----------------------------------------|------------|-----------------------------------|
|                                              | Balance<br>at<br>Beginning<br>of<br>Period | Charged<br>to Costs<br>and<br>Expenses | Deductions | Balance<br>at End<br>of<br>Period |
| Allowance for doubtful accounts:             |                                            |                                        |            |                                   |
| Year ended December 31, 2016                 | \$543                                      | \$ 361                                 | \$ (450 )  | (1) \$454                         |
| Year ended December 31, 2015                 | 733                                        | 353                                    | (543 )     | (1) 543                           |
| Year ended December 31, 2014                 | 828                                        | 715                                    | (810 )     | (1) 733                           |
| Valuation allowance for deferred tax assets: |                                            |                                        |            |                                   |
| Year ended December 31, 2016                 | \$36,516                                   | \$ (1,100 )                            | \$ —       | \$35,416                          |
| Year ended December 31, 2015                 | 36,675                                     | (159 )                                 | —          | 36,516                            |
| Year ended December 31, 2014                 | 35,834                                     | 841                                    | —          | 36,675                            |

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

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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.

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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. (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, 2016. In making this evaluation, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission "Internal Control – Integrated Framework" (2013). Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2016. The Company's independent registered public accounting firm, BDO USA, 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

Board of Directors and Stockholders

Lawson Products, Inc.

Chicago, Illinois

We have audited Lawson Products, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in "Internal Control – Integrated Framework" (2013) 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 Item 9A, Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on 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, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included 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 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, 2016, 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, 2016 and 2015, and the related consolidated statements of operations and comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016 and our report dated February 23, 2017 expressed an unqualified opinion thereon.

/s/BDO USA, LLP

Chicago, IL

February 23, 2017



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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.

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 16, 2017, 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 16, 2017, 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.

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 16, 2017, under the caption "Remuneration of Executive Officers," which information is incorporated herein by reference.

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Table of Contents**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 16, 2017 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, 2016 regarding the number of shares of common stock that were available for issuance under the Company's equity compensation plans which are described in greater detail in Note 14 in the Consolidated Financial Statements.

| Plan category                                              | Number of securities to be issued upon exercise of outstanding options, warrants and rights<br>(1) | Weighted-average exercise price of outstanding options, warrants and rights<br>(1) (2) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column) |
|------------------------------------------------------------|----------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders     | 342,105                                                                                            | \$18.84                                                                                | 414,967                                                                                                                                           |
| Equity compensation plans not approved by security holders | —                                                                                                  | —                                                                                      | —                                                                                                                                                 |
| Total                                                      | 342,105                                                                                            | \$18.84                                                                                | 414,967                                                                                                                                           |

(1) Includes potential common stock issuance of 31,897 from restricted stock awards, 224,298 from market stock units, 45,910 from stock options and 40,000 from stock awards.

(2) Weighted-average exercise price of 45,910 stock options and 40,000 stock awards.

**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 16, 2017 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 16, 2017 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 23.
- (2) See Schedule II in Item 8 on page 47.
- (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/ Michael G. DeCata

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

Date: February 23, 2017

By: /s/ Ronald J. Knutson

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

Date: February 23, 2017

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below this 23rd day of February, 2017, by the following persons on behalf of the registrant and in the capacities indicated.

| Signature                                  | Title                 |
|--------------------------------------------|-----------------------|
| /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              |
|                                            | Director              |

/s/ Lee S. Hillman  
Lee S. Hillman

/s/ Thomas S. Postek     Director  
Thomas S. Postek

/s/ Wilma J. Smelcer     Director  
Wilma J. Smelcer

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EXHIBIT INDEX

| Exhibit Number | Description of Exhibit                                                                                                                                                                                                                                   |
|----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 2.1            | Asset Purchase Agreement dated November 15, 2016 between the Company and Mattic Industries LTD incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated November 15, 2016.                                     |
| 2.2            | Amending Agreement dated November 15, 2016 between the Company and Mattic Industries LTD incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated November 15, 2016.                                           |
| 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 Exhibit 3.1 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*          | 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.                                                                  |
| 10.4*          | 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.                                                                                         |
| 10.5*          | Form of Indemnification Agreement for Directors and Officers incorporated herein by reference to Exhibit 10.01 to the Company's Current Report on Form 8-K dated September 15, 2008.                                                                     |
| 10.6*          | 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.                                                                                             |
| 10.7           | Loan and Security Agreement dated August 8, 2012 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 8, 2012.                           |
| 10.8*          | Employment Agreement dated as of August 29, 2012 by and between Lawson Products, Inc., an Illinois corporation, and Neil E. Jenkins, incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated August 29, 2012. |
| 10.9*          | Employment Agreement dated as of August 29, 2012 by and between Lawson Products, Inc., an Illinois corporation, and Ron Knutson, incorporated herein by reference to Exhibit 10.3 to the Company's Current Report on Form 8-K dated August 29, 2012.     |
| 10.10          |                                                                                                                                                                                                                                                          |

First Amendment to Loan and Security Agreement dated September 25, 2013 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 25, 2013.

- 10.11 Second Amendment to Loan and Security Agreement dated December 20, 2013 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 20, 2013.

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- 10.12 Third Amendment to Loan and Security Agreement dated February 14, 2013 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 February 14, 2014.
- 10.13 Real Estate Sales Contract and Escrow Instructions dated May 12, 2014 between the Company and KTR Property Trust III incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated May 12, 2014.
- 10.14 Agreement of Lease dated June 30, 2014 between the Company and KTR Property Trust III incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated June 30, 2014.
- 10.15\* Employment Agreement dated as of January 12, 2015 by and between Lawson Products, Inc., an Illinois corporation, and Michael G. DeCata, incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated January 12, 2015.
- 10.16\* Award Agreement dated as of January 12, 2015 by and between Lawson Products, Inc., an Illinois corporation, and Michael G. DeCata, incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated January 12, 2015.
- 10.17\* Confidential Separation Agreement and General Release dated as of September 15, 2015, between Lawson Products, Inc. and Allen D. Jacobson, incorporated by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K dated September 15, 2015.
- 10.18 Consent to Loan and Security Agreement dated September 30, 2015 between the Company and The PrivateBank and Trust Company.
- 10.19\* Change in Control Agreement effective October 16, 2015 by and between the Company and Shane McCarthy, incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K dated October 16, 2015
- 10.20 Consent to Loan and Security Agreement dated March 7, 2016 between the Company and The PrivateBank and Trust Company.
- 10.21 Fourth Amendment to Loan and Security Agreement dated April 11, 2016 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 April 11, 2016.
- 10.22 Fifth Amendment to Loan and Security Agreement dated June 30, 2016 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 June 30, 2016.
- 10.23 Sixth Amendment to Loan and Security Agreement dated September 30, 2016 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, 2016.
- 10.24 Seventh Amendment to Loan and Security Agreement dated February 14, 2017 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 February 14, 2017.

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|---------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 21      | Subsidiaries of the Company.                                                                                                                                                  |
| 23      | Consent of BDO USA, 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.DEF | XBRL Taxonomy Extension Definition 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.