

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

(Mark One)

Quarterly Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934
For quarterly period ended June 30, 2008

or

Transition Report under Section 13 OR 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____

Commission file Number: 0-10546

LAWSON PRODUCTS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

36-2229304

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

1666 East Touhy Avenue, Des Plaines, Illinois

(Address of principal executive offices)

60018

(Zip Code)

(847) 827-9666

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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

Smaller reporting company

(Do not check if a 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 number of shares outstanding of the registrant's common stock, \$1 par value, as of August 11, 2008 was 8,522,001.

“Safe Harbor” Statement under the Securities Litigation Reform Act of 1995: This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties. The terms “may,” “should,” “could,” “anticipate,” “believe,” “continues,” “estimate,” “expect,” “intend,” “objective,” “plan,” “potential,” “project” and similar 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 market reaction to the signing of a Deferred Prosecution Agreement with U.S. Attorney’s Office for the Northern District of Illinois and any subsequent breach of the terms and conditions of such agreement; excess and obsolete inventory; disruptions of the Company’s information systems; risks of rescheduled or cancelled orders; increases in commodity prices; the influence of controlling stockholders; competition and competitive pricing pressures; the effect of general economic conditions and market conditions in the markets and industries the Company serves; the risks of war, terrorism, and similar hostilities; and, all of the factors discussed in the Company’s “Risk Factors” set forth in its Annual Report on Form 10-K for the year ended December 31, 2007.

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

TABLE OF CONTENTS

PART I-FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 4. CONTROLS AND PROCEDURES

PART II-OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

ITEM 1A. RISK FACTORS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

ITEM 5. OTHER INFORMATION

ITEM 6. EXHIBITS

SIGNATURES

PART I-FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**Lawson Products, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets**

(Amounts in thousands, except share and per share data)	June 30, 2008 (UNAUDITED)	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,070	\$ 1,671
Accounts receivable, less allowance for doubtful accounts	55,998	58,882
Inventories	95,906	96,785
Miscellaneous receivables and prepaid expenses	10,821	10,303
Deferred income taxes	2,984	3,226
Discontinued current assets	394	1,064
Total current assets	171,173	171,931
Property, plant and equipment, less accumulated depreciation and amortization	50,467	53,031
Deferred income taxes	20,380	21,344
Goodwill	27,999	27,999
Other assets	25,233	25,558
Total assets	\$ 295,252	\$ 299,863
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 15,715	\$ 16,266
Revolving line of credit	13,500	11,000
Settlement payable — current (Note J)	10,000	—
Accrued expenses and other liabilities	39,708	45,254
Discontinued current liabilities	120	322
Total current liabilities	79,043	72,842
Accrued liability under security bonus plans	25,900	25,491
Settlement payable — noncurrent (Note J)	20,000	—
Other	24,752	27,169
	70,652	52,660
Stockholders' equity:		
Preferred stock, \$1 par value:		
Authorized - 500,000 shares, Issued and outstanding — None	—	—
Common stock, \$1 par value:		
Authorized - 35,000,000 shares, Issued and outstanding - 8,522,001 shares in 2008 and 2007	8,522	8,522
Capital in excess of par value	4,774	4,774
Retained earnings	131,914	160,606
Accumulated other comprehensive income	347	459
Total stockholders' equity	145,557	174,361
Total liabilities and stockholders' equity	\$ 295,252	\$ 299,863

See notes to condensed consolidated financial statements.

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

(in thousands, except per share data)	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Net sales	\$ 126,310	\$ 129,178	\$ 251,314	\$ 258,847
Cost of goods sold	<u>53,704</u>	<u>52,481</u>	<u>105,446</u>	<u>106,323</u>
Gross profit	72,606	76,697	145,868	152,524
Operating expenses:				
Selling, general and administrative expenses	65,411	68,588	129,373	133,463
Settlement and related costs (Note J)	30,417	2,689	31,168	3,775
Severance and other charges	<u>5,913</u>	<u>5,642</u>	<u>6,515</u>	<u>7,363</u>
Operating (loss) income	(29,135)	(222)	(21,188)	7,923
Investment and other income	165	293	273	395
Interest expense	<u>(214)</u>	<u>(286)</u>	<u>(443)</u>	<u>(367)</u>
(Loss) income from continuing operations before income taxes	(29,184)	(215)	(21,358)	7,951
Provision (benefit) for income taxes	<u>51</u>	<u>(195)</u>	<u>3,353</u>	<u>3,245</u>
(Loss) income from continuing operations	(29,235)	(20)	(24,711)	4,706
Loss from discontinued operations, net of income taxes	<u>(418)</u>	<u>(329)</u>	<u>(573)</u>	<u>(485)</u>
Net (loss) income	<u>\$ (29,653)</u>	<u>\$ (349)</u>	<u>\$ (25,284)</u>	<u>\$ 4,221</u>
Basic (loss) income per share of common stock:				
Continuing operations	\$ (3.43)	\$ (0.00)	\$ (2.90)	\$ 0.55
Discontinued operations	<u>(0.05)</u>	<u>(0.04)</u>	<u>(0.07)</u>	<u>(0.06)</u>
	<u>\$ (3.48)</u>	<u>\$ (0.04)</u>	<u>\$ (2.97)</u>	<u>\$ 0.50</u>
Diluted (loss) income per share of common stock:				
Continuing operations	\$ (3.43)	\$ (0.00)	\$ (2.90)	\$ 0.55
Discontinued operations	<u>(0.05)</u>	<u>(0.04)</u>	<u>(0.07)</u>	<u>(0.06)</u>
	<u>\$ (3.48)</u>	<u>\$ (0.04)</u>	<u>\$ (2.97)</u>	<u>\$ 0.50</u>
Cash dividends declared per share of common stock	<u>\$ 0.20</u>	<u>\$ 0.20</u>	<u>\$ 0.40</u>	<u>\$ 0.40</u>
Weighted average shares outstanding:				
Basic	<u>8,522</u>	<u>8,522</u>	<u>8,522</u>	<u>8,521</u>
Diluted	<u>8,522</u>	<u>8,522</u>	<u>8,522</u>	<u>8,523</u>

See notes to condensed consolidated financial statements.

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

(Amounts in thousands)	For the Six Months Ended June 30,	
	2008	2007
Operating activities:		
Net (loss) income	\$ (25,284)	\$ 4,221
Adjustments to reconcile net (loss) income to net cash provided by (used for) operating activities:		
Depreciation and amortization	4,353	3,890
Provision for settlement	30,000	—
Changes in operating assets and liabilities	(2,154)	(12,705)
Other	(1,529)	988
Net cash provided by (used for) operating activities	<u>5,386</u>	<u>(3,606)</u>
Investing activities:		
Additions to property, plant and equipment	(1,664)	(10,440)
Net cash used for investing activities	<u>(1,664)</u>	<u>(10,440)</u>
Financing activities:		
Proceeds from revolving line of credit, net of payments	2,500	16,000
Dividends paid	(3,409)	(3,409)
Other	—	27
Net cash (used for) provided by financing activities	<u>(909)</u>	<u>12,618</u>
Increase (decrease) in cash and cash equivalents	2,813	(1,428)
Cash and cash equivalents at beginning of period	<u>2,473</u>	<u>4,320</u>
Cash and cash equivalents at end of period	5,286	2,892
Cash held by discontinued operations	<u>(216)</u>	<u>(1,031)</u>
Cash and cash equivalents held by continuing operations at end of period	<u>\$ 5,070</u>	<u>\$ 1,861</u>

See notes to condensed consolidated financial statements.

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

Note A — Basis of Presentation and Summary of Significant Accounting Policies

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not contain all disclosures required by generally accepted accounting principles. Reference should be made to Lawson Products, Inc.'s (the "Company") Annual Report on Form 10-K for the year ended December 31, 2007. The Condensed Consolidated Balance Sheet as of June 30, 2008, the Condensed Consolidated Statements of Operations for the three-month and six-month periods ended June 30, 2008 and 2007 and the Condensed Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2008 and 2007 are unaudited. In the opinion of the Company, all adjustments (consisting only of normal recurring accruals) have been made, which are necessary to present fairly the results of operations for the interim periods. Operating results for the three and six-month period ended June 30, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

There have been no material changes in our significant accounting policies during the six months ended June 30, 2008 as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

Certain severance and settlement costs have been reclassified from selling, general and administrative expenses to separate line items within the Condensed Consolidated Statements of Operations.

Note B — Comprehensive Income (Loss)

Comprehensive loss was \$29,574 for the second quarter of 2008 compared to comprehensive income of \$48 for the second quarter of 2007. Comprehensive income (loss) was positively impacted by foreign currency translation adjustments of \$79 and \$397 for the three-month periods ended June 30, 2008 and 2007, respectively.

For the six-month period ended June 30, 2008, comprehensive loss was \$25,396, and for the six-month period ended June 30, 2007, comprehensive income was \$4,677. Comprehensive income (loss) was negatively impacted by foreign currency translation adjustments of \$112 for the six-month period ended June 30, 2008 and positively impacted by foreign currency translation adjustments of \$456 for the six-month period ended June 30, 2007.

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

Note C — Earnings Per Share

The calculation of dilutive weighted average shares outstanding for the three and six months ended June 30, 2008 and 2007 are as follows (in thousands):

	<u>Three months ended June 30</u>	
	<u>2008</u>	<u>2007</u>
Basic weighted average shares outstanding	8,522	8,522
Dilutive impact of options outstanding	—	—
Dilutive weighted average shares outstanding	<u>8,522</u>	<u>8,522</u>
	<u>Six months ended June 30</u>	
	<u>2008</u>	<u>2007</u>
Basic weighted average shares outstanding	8,522	8,521
Dilutive impact of options outstanding	—	2
Dilutive weighted average shares outstanding	<u>8,522</u>	<u>8,523</u>

For the three months ended June 30, 2008 and 2007 and the six months ended June 30, 2008, stock options were excluded from the computation of diluted earnings per share since inclusion of those options would have been anti-dilutive.

Note D — Revolving Line of Credit

The revolving line of credit has a maximum borrowing capacity of \$75 million and a maturity date of March 27, 2009. The revolving line of credit carries a floating interest rate of prime minus 1.5% or LIBOR plus 0.75%, at the Company’s option. At June 30, 2008, the effective rate was 3.1%. Interest is payable quarterly on prime rate borrowings and at contract expirations for LIBOR borrowings. The Company had \$13.5 million of borrowings under the line of credit at June 30, 2008.

The line of credit contains certain financial covenants regarding interest coverage, minimum stockholders’ equity and working capital. As of June 30, 2008, the Company received a waiver with respect to certain covenants related to EBITDA ratios as defined in the revolving credit agreement. This waiver was necessitated by the \$30,000 provision made in connection with the settlement of the investigation by the U.S. Attorney’s Office (see Note J). The Company has entered into an amendment to its revolving credit agreement in the third quarter of 2008 modifying certain covenant calculations for the \$30,000 provision.

Note E — Severance and Other Charges

For the three months ended June 30, 2008, severance and other charges of \$5,913 includes charges of \$2,313 of severance and \$3,600 related to liabilities for unclaimed property relating primarily to years prior to 2003. For the six months ended June 30, 2008, severance and other charges were \$6,515, consisting of \$2,915 of severance and \$3,600 for liabilities for unclaimed property.

The table below shows the changes in the Company’s reserves for severance and related payments, included in accrued expenses and other liabilities on the balance sheet as of June 30, 2008 and 2007:

	2008	2007
Balance at beginning of year	\$ 7,058	\$ 962
Charged to earnings	2,915	7,363
Cash paid	(2,804)	(2,906)
Adjustment to reserves	(42)	(120)
Balance at June 30	\$ 7,127	\$ 5,299

Note F — Intangible Assets

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

	June 30, 2008		
	Gross Balance	Accumulated Amortization	Net Carrying Amount
Trademarks and tradenames	\$ 1,400	\$ 762	\$ 638
Non-compete covenant	1,000	500	500
	<u>\$ 2,400</u>	<u>\$ 1,262</u>	<u>\$ 1,138</u>
	December 31, 2007		
	Gross Balance	Accumulated Amortization	Net Carrying Amount
Trademarks and tradenames	\$ 1,400	\$ 737	\$ 663
Non-compete covenant	1,000	400	600
	<u>\$ 2,400</u>	<u>\$ 1,137</u>	<u>\$ 1,263</u>

Trademarks and tradenames are being amortized over 20 years. The non-compete covenant associated with the 2005 acquisition of Rutland is being amortized over 5 years. Amortization expense, all of which is included in the MRO distribution segment, for these intangible assets is expected to be \$250 per year for each of the next two and one-half years and \$50 per year thereafter until the trademarks and tradenames are fully amortized.

Note G — Stock-Based Compensation

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

Stock Performance Rights

SPRs vest at 20 percent or 33 percent per year and entitle the recipient to receive a cash payment equal to the excess of the market value of the Company’s common stock over the SPR exercise price when the SPRs are surrendered. The Company estimates the fair value of SPRs using the Black-Scholes valuation model each quarter. This model requires the input of subjective assumptions that will usually have a significant impact on the fair value estimate. The weighted-average estimated fair value of SPRs outstanding at June 30, 2008 was \$5.63 per SPR with the following assumptions:

	<u>June 30, 2008</u>
Expected volatility	39.73% to 52.09%
Risk-free interest rate	2.42% to 3.46%
Expected term (in years)	1.2 to 5.9
Expected dividend yield	3.23%

Compensation expense of \$0.1 million and \$0.5 million was recorded for outstanding SPRs in selling, general and administrative expenses in the second quarters of 2008 and 2007, respectively. Compensation income of \$1.1 million and \$0.2 million was recorded for outstanding SPRs in the first six months of 2008 and 2007, respectively.

The following is a summary of the activity in the Company’s SPRs during the three and six month periods ended June 30, 2008:

	<u>Average SPR Exercise Price</u>	<u># of SPRs</u>
Outstanding December 31, 2007 (1)	\$ 34.17	209,250
Granted	25.43	86,500
Exercised	27.08	(28,000)
Outstanding March 31, 2008 (2)	\$ 32.09	267,750
Granted	26.33	65,000
Forfeited	<u>25.53</u>	<u>(24,100)</u>
Outstanding June 30, 2008 (3)	<u>\$ 31.39</u>	<u>308,650</u>

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

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

(3) Includes 137,517 SPRs vested at June 30, 2008 at a weighted average exercise price of \$34.52 per SPR.

The aggregate intrinsic value of SPRs outstanding as of June 30, 2008 is \$(0.9) million.

As of June 30, 2008, there was \$0.8 million of unrecognized compensation cost related to non-vested SPRs, which will be recognized over a weighted average period of 1.8 years.

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

Stock Options

There were no stock options granted, exercised or cancelled in the first six months of 2008. As of June 30, 2008, the Company had 5,000 outstanding stock options at a weighted average exercise price of \$23.11 with the following characteristics:

Exercise price	\$23.56	\$22.44
Options outstanding:	3,000	2,000
Weighted average exercise price	\$23.56	\$22.44
Weighted average remaining life (in years)	1.9	1.1
Options exercisable:	3,000	2,000
Weighted average exercise price	\$23.56	\$22.44

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

Note H — Segment Reporting

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

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

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

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

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

	Three Months Ended June 30	
	2008	2007
Net sales		
MRO	\$ 104,781	\$ 108,875
OEM	21,529	20,303
Consolidated total	<u>\$ 126,310</u>	<u>\$ 129,178</u>
Operating loss		
MRO	\$ (29,466)	\$ (1,075)
OEM	331	853
Consolidated total	<u>\$ (29,135)</u>	<u>\$ (222)</u>

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

	Three Months Ended June 30	
	2008	2007
Total operating loss from reportable segments	\$ (29,135)	\$ (222)
Investment and other income	165	293
Interest expense	(214)	(286)
Loss from continuing operations before income taxes	<u>\$ (29,184)</u>	<u>\$ (215)</u>

	Six Months Ended June 30	
	2008	2007
Net sales		
MRO	\$ 209,319	\$ 215,161
OEM	41,995	43,686
Consolidated total	<u>\$ 251,314</u>	<u>\$ 258,847</u>
Operating (loss) income		
MRO	\$ (21,972)	\$ 5,198
OEM	784	2,725
Consolidated total	<u>\$ (21,188)</u>	<u>\$ 7,923</u>

The reconciliation of operating loss from reportable segment to consolidated loss segment profit for continuing operations to consolidated (loss) income before income taxes consisted of the following:

	Six Months Ended June 30	
	2008	2007
Total operating (loss) income from reportable segments	\$ (21,188)	\$ 7,923
Investment and other income	273	395
Interest expense	(443)	(367)
(Loss) income from continuing operations before income taxes	<u>\$ (21,358)</u>	<u>\$ 7,951</u>

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

	June 30, 2008	December 31, 2007
Total assets		
MRO	\$ 218,597	\$ 221,274
OEM	52,897	52,955
Total for reportable segments	271,494	274,229
Corporate	23,364	24,570
Consolidated total	<u>\$ 294,858</u>	<u>\$ 298,799</u>

At June 30, 2008 and December 31, 2007, the carrying value of goodwill within each reportable segment was as follows (in thousands):

MRO	\$ 25,748
OEM	2,251
Consolidated total	<u>\$ 27,999</u>

Note I — Income Tax Expense

For the three months ended June 30, 2008, income tax expense was \$51, based on a pre-tax loss from continuing operations of \$29,184. For the six months ended June 30, 2008, income tax expense was \$3,353, based on a pre-tax loss from continuing operations of \$21,358. The Company did not record a tax benefit in the quarter ended June 30, 2008 related to approximately \$29,200 of the \$30,000 provision in connection with the settlement of the investigation by the U.S. Attorney's Office for the Northern District of Illinois since the amount is not deductible for tax purposes, resulting in a tax rate that is not meaningful in each of the periods (See Note J).

At June 30, 2008, the Company had \$923 in unrecognized tax benefits, the recognition of which 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 June 30, 2008 balance of unrecognized tax benefits represent tax positions that could significantly change during the next twelve months.

The Company's continuing practice is to recognize interest and penalties related to unrecognized tax benefits in income tax expense. The Company had \$1,474 accrued for interest and penalties at June 2008.

The Company and its subsidiaries are subject to U.S. Federal income tax as well as income tax of multiple state and international jurisdictions. As of June 30, 2008, the Company is subject to U.S. Federal income tax examinations for the years 2000 through 2006 and to non-U.S. income tax examinations for the tax years of 2000 through 2006. In addition, the Company is subject to state and local income tax examinations for the tax years 2000 through 2006.

Note J — Legal Proceedings

In December 2005, the FBI executed a search warrant for records at the Company's offices and informed the Company that it was conducting an investigation as to whether any of the Company's representatives improperly provided gifts or awards to purchasing agents (including government purchasing agents) through the Company's customer loyalty programs (the "investigation"). The U.S. Attorney's Office for the Northern District of Illinois (the "U.S. Attorney's Office") subsequently issued a subpoena for documents in connection with the investigation.

In April 2007, thirteen people, including seven former sales agents of the Company, were indicted on federal criminal charges, including mail fraud, in connection with the investigation. These indictments alleged that, under the Company's customer loyalty programs, sales agents would provide cash gift certificates to individuals purchasing Company merchandise on behalf of their employers as a way to increase their commissions and prices paid by customers. All of the cases involved commissioned sales agents of the Company. All seven of the indicted former sales agents have entered guilty pleas to federal criminal charges.

On August 11, 2008, in connection with the investigation, the Company entered into a Deferred Prosecution Agreement (the "DPA") with the U.S. Attorney's Office. Under the terms of the DPA, the U.S. Attorney's Office will file a one-count criminal Information charging the Company with mail fraud in the U.S. District Court for the Northern District of Illinois, but will defer prosecution of such charge for three years. If the Company abides by the terms and conditions of the DPA, the U.S. Attorney's Office will seek dismissal with prejudice of the Information within 30 days of the expiration of the three-year period.

Pursuant to the DPA, the Company has agreed to a \$30,000 penalty which includes \$806 of restitution, and has recorded a charge of \$30,000 in the second quarter of 2008. The penalty is payable in three equal installments. The first \$10,000 payment was made on the date the DPA was signed. The second \$10,000 payment will be paid within the first twelve months of the signing of the DPA, and the final \$10,000 payment will be paid within twenty-four months of the signing of the DPA. If a controlling interest in the Company is sold, any unpaid amounts shall be accelerated and due at the closing of the sale.

In addition, the Company has also agreed to make restitution payments to those customers that employed individuals who received over \$10 in payments through the Winners Choice incentive program, or that employed individuals who have been or later are convicted of mail fraud as a result of Winners Choice payments, or that purchased Company merchandise from sales agents who have been or later are convicted of mail fraud for providing checks to the customer's employees. Restitution payments made to these customers will reduce the amount of the Company's first installment payment in an equal amount.

In conjunction with the Company's internal investigation, several customer loyalty programs were terminated because the Company believes that these programs provided or had the potential of providing promotional considerations, such as gifts and awards, to purchasing agents that the Company has deemed inappropriate. The Company has modified another customer loyalty program to limit the amount and nature of customer gifts distributed under the program. In addition, twenty-three independent agents have been terminated, a number have resigned and the Company has terminated four employees. The Company has also implemented a compliance and ethics program to prevent future abuses. Under the terms of the DPA, the Company agreed to continue to implement its compliance and ethics program.

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Lawson Products, Inc.

We have reviewed the condensed consolidated balance sheet of Lawson Products, Inc. and subsidiaries as of June 30, 2008 and the related condensed consolidated statements of operations for the three and six month periods ended June 30, 2008 and 2007 and the related condensed consolidated statements of cash flows for the six month periods ended June 30, 2008 and 2007. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Lawson Products, Inc. and subsidiaries as of December 31, 2007, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the year then ended, not presented herein, and in our report dated March 10, 2008, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

ERNST & YOUNG LLP
Chicago, Illinois
August 11, 2008

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Quarter ended June 30, 2008 compared to Quarter ended June 30, 2007

The following table presents a summary of the Company's financial performance for the second quarters of 2008 and 2007:

(Dollars in thousands)	2008	% of Net Sales	2007	% of Net Sales
Net sales	\$ 126,310	100.0	\$ 129,178	100.0
Cost of goods sold	53,704	42.5	52,481	40.6
Gross profit	72,606	57.5	76,697	59.4
Operating expenses:				
Selling, general and administrative expenses	65,411	51.8	68,588	53.1
Settlement and related costs	30,417	24.1	2,689	2.1
Severance and other charges	5,913	4.7	5,642	4.4
Operating loss	(29,135)	(23.1)	(222)	(0.2)
Other, net	(49)	(0.0)	7	0.0
Loss from continuing operations before income tax expense	(29,184)	(23.1)	(215)	(0.2)
Income tax expense (benefit)	51	0.0	(195)	(0.2)
Loss from continuing operations	(29,235)	(23.1)	(20)	(0.0)
Loss from discontinued operations	(418)	(0.3)	(329)	(0.3)
Net loss	<u>\$ (29,653)</u>	<u>(23.5)</u>	<u>\$ (349)</u>	<u>(0.3)</u>

Net Sales and Gross Profit

Net sales for the three-month period ended June 30, 2008 decreased 2.2 percent to \$126.3 million, from \$129.2 million in the same period of 2007.

The following table presents the Company's net sales results for its Maintenance, Repair and Operations distribution (MRO) and Original Equipment Manufacturer (OEM) businesses for the second quarter of 2008 and 2007:

(Dollars in millions)	2008	2007
MRO	\$ 104.8	\$ 108.9
OEM	21.5	20.3
	<u>\$ 126.3</u>	<u>\$ 129.2</u>

MRO net sales decreased \$4.1 million or 3.8 percent in the second quarter of 2008, to \$104.8 million from \$108.9 million in the prior year period. MRO net sales declined primarily as a result of lower sales in metal working products and chemicals. These categories were negatively impacted by a net reduction of 80 sales agents from June 30, 2007 to June 30, 2008.

OEM net sales increased \$1.2 million in the second quarter of 2008, to \$21.5 million from \$20.3 million in the prior year period. The sales increase experienced during the second quarter was primarily attributable to winning additional business from current OEM customers which is one of the Company's 2008 goals.

Gross profit margins for the second quarter 2008 were 57.5 percent, 1.9 percent lower than the 59.4 percent achieved in the second quarter of 2007. The decline in gross profit margin is primarily attributable to a change in sales mix and increased product and commodity costs. The Company announced price increases, effective July 1, 2008, to partially recover these cost increases.

Operating Expenses and Operating Income

Selling, General and Administrative Expenses (“SG&A”)

SG&A expenses were \$65.4 million and 51.8 percent of net sales and \$68.6 million and 53.1 percent of net sales for the quarters ended June 30, 2008 and 2007, respectively. The \$3.2 million reduction in second quarter 2008 SG&A expenses reflects lower sales commission and employee compensation costs, offset partially by higher supplies and consulting fees.

Settlement and Related Costs

During the second quarter of 2008, the Company recorded a \$30.0 million provision for penalties in connection with the settlement of the investigation by the U.S. Attorney’s Office for the Northern District of Illinois. In addition, the Company had expenses of \$0.4 million and \$2.7 million in costs related to the investigation in 2008 and 2007, respectively. See Note J to the Condensed Consolidated Financial Statements for further information.

Severance and Other Charges

In the second quarter of 2008, the Company recorded \$5.9 million of severance and other charges. Of this amount, \$2.3 million related to severance costs associated with the departure of five executives and operational efficiency improvement initiatives implemented in 2008 and \$3.6 million related to unclaimed property liabilities relating primarily to years prior to 2003. In the second quarter of 2007, the Company recorded \$5.6 million of severance.

Operating Loss

Operating loss for the three-month period ended June 30, 2008 increased to \$29.1 million, from a loss of \$0.2 million in the same period of 2007. This \$28.9 million increase in operating loss is principally due to the \$30.0 million provision to settle the investigation (see Note J) and \$4.1 million of lower gross profit, offset partially by \$3.2 million of lower selling, general and administrative expenses. The factors affecting these items are discussed above.

Income Tax Expense

For the three months ended June 30, 2008, the Company recorded \$0.1 million of income tax expense, based on a pre-tax loss from continuing operations of \$29.2 million. \$29.2 million of the \$30.0 million provision recorded during the period in connection with the settlement with the U.S. Attorney’s Office for the Northern District of Illinois is not deductible for tax purposes, resulting in an effective tax rate that is not meaningful. For the three months ended June 30, 2007, there was a tax benefit of \$0.2 million, based on a pre-tax loss of \$0.2 million, resulting in an effective tax rate of 91.1%.

Loss from Discontinued Operations

Loss from discontinued operations of \$0.4 million for the second quarter of 2008 as well as the \$0.3 million loss for the second quarter of 2007 reflects the impact of operating losses and costs associated with the closure of the Company’s Mexico operations and the liquidation of the Company’s UK operations.

Six Months ended June 30, 2008 compared to Six Months ended June 30, 2007

The following table presents a summary of the Company's financial performance for the six months ended June 30, 2008 and 2007:

(Dollars in thousands)	2008	% of Net Sales	2007	% of Net Sales
Net sales	\$ 251,314	100.0	\$ 258,847	100.0
Cost of goods sold	105,446	42.0	106,323	41.1
Gross profit	145,868	58.0	152,524	58.9
Operating expenses:				
Selling, general and administrative expenses	129,373	51.5	133,463	51.6
Settlement and related costs	31,168	12.4	3,775	1.5
Severance and other charges	6,515	2.6	7,363	2.8
Operating (loss) income	(21,188)	(8.4)	7,923	3.1
Other, net	(170)	(0.1)	28	0.0
(Loss) income from continuing operations before income tax expense	(21,358)	(8.5)	7,951	3.1
Income tax expense	3,353	1.3	3,245	1.3
(Loss) income from continuing operations	(24,711)	(9.8)	4,706	1.8
Loss from discontinued operations	(573)	(0.2)	(485)	(0.2)
Net (loss) income	<u>\$ (25,284)</u>	<u>(10.0)</u>	<u>\$ 4,221</u>	<u>1.6</u>

Net Sales and Gross Profit

Net sales for the six-month period ended June 30, 2008 decreased 2.9 percent to \$251.3 million, from \$258.8 million in the same period of 2007.

The following table presents the Company's net sales results for its Maintenance, Repair and Operations distribution (MRO) and Original Equipment Manufacturer (OEM) businesses for the first six months of 2008 and 2007:

(Dollars in millions)	2008	2007
MRO	\$ 209.3	\$ 215.1
OEM	42.0	43.7
	<u>\$ 251.3</u>	<u>\$ 258.8</u>

MRO net sales decreased \$5.8 million or 2.7 percent in the first six months of 2008, to \$209.3 million from \$215.1 million in the prior year period. MRO net sales declined primarily as a result of lower sales in metal working products and chemicals. These categories were negatively impacted by a net reduction of 80 sales agents from June 30, 2007 to June 30, 2008.

OEM net sales decreased \$1.7 million in the first six months of 2008, to \$42.0 million from \$43.7 million in the prior year period. The sales decline was primarily attributable to lower first quarter sales of \$2.9 million resulting from customers that were lost in 2007. This was partially offset by a \$1.2 million increase in second quarter sales which is primarily attributable to additional business from current OEM customers which is one of the Company's 2008 goals.

Gross profit margins for the first six months of 2008 were 58.0 percent down 0.9 percent from 58.9 percent in the first six months of 2007. The decline in gross profit margin is primarily attributable to a second quarter change in sales mix and increased product and commodity costs. The Company announced price increases, effective July 1, 2008, to partially recover these cost increases.

Operating Expenses and Operating Income

Selling, General and Administrative Expenses (“SG&A”)

SG&A expenses were \$129.4 million and 51.5 percent of net sales and \$133.5 million and 51.6 percent of net sales for the six-months ended June 30, 2008 and 2007, respectively. The \$4.1 million reduction in SG&A expenses reflects lower sales commission and employee compensation costs, offset partially by higher supplies and consulting fees.

Settlement and Related Costs

The Company incurred penalties and related costs of \$31.2 million in the first six-months of 2008 and investigation costs of \$3.8 million in the first six-months of 2007 in conjunction with the investigation by the U.S. Attorney’s Office for the Northern District of Illinois related to whether Company sales representatives provided improper gifts or awards to purchasing agents (including government purchasing agents) through the Company’s customer loyalty programs. See Note J in the Condensed Consolidated Financial Statements for further information.

Severance and Other Charges

In the first six-months of 2008, the Company recorded \$6.5 million of severance and other charges. Of this amount, \$2.9 million related to severance costs associated with the departure of seven executives and operational efficiency improvement initiatives implemented in 2008 and \$3.6 million related to unclaimed property liabilities relating primarily to years prior to 2003. In the first six-months of 2007, the Company recorded \$7.4 million of severance and other charges.

Operating Income (Loss)

Operating loss for the six-month period ended June 30, 2008 was \$21.2 million compared to operating income of \$7.9 million in the same period of 2007. This \$29.1 million change is principally due to the \$30 million provision to settle the investigation (see Note J) and \$6.7 million of lower gross profit, offset partially by \$4.1 million of lower selling, general and administrative expenses as well as \$0.8 million of lower severance and other charges. The factors affecting these items are discussed above.

Income Tax Expense

For the six months ended June 30, 2008, the Company recorded \$3.4 million of income tax expense, based on a pre-tax loss from continuing operations of \$21.4 million. \$29.2 million of the \$30.0 million provision recorded during the period in connection with the settlement with the U.S. Attorney’s Office for the Northern District of Illinois is not deductible for tax purposes, resulting in a tax rate that is not meaningful. For the six months ended June 30, 2007, the effective tax rate was 40.8%.

Loss from Discontinued Operations

Loss from discontinued operations of \$0.6 million for the first six-months of 2008 as well as the \$0.5 million loss for the first six-months of 2007 reflects the impact of operating losses and costs associated with the closure of the Company’s Mexico operations and the liquidation of the Company’s UK operations.

Liquidity and Capital Resources

Net cash provided by operations was \$5.4 million for the first six months of 2008. Net cash used for operations was \$3.6 million in the first six months of 2007. The \$9.0 million increase in cash provided by operations as compared to the prior period is primarily due improvements in working capital utilization.

Net cash used for investing activities decreased \$8.8 million for the six-month period ended June 30, 2008 compared to the prior year period reflecting lower capital expenditures in the first half of 2008. Capital expenditures in 2008 of \$1.7 million were principally related to improvement of existing facilities and the purchase of related equipment. For the 2007 period, capital expenditures of \$10.4 million were principally related to the Reno, Nevada facility expansion, which was completed in 2007.

Net cash used in financing activities in the first six months of 2008 was \$0.9 million compared to net cash provided by operating activities of \$12.6 million in the first six months of 2007, reflecting borrowings and payments on the Company’s revolving line of credit.

Working capital, including cash and cash equivalents, at June 30, 2008, was \$92.1 million as compared to \$99.1 million at December 31, 2007. The decrease in working capital is primarily attributable to the

\$10.0 million current liability relating to settlement of the investigation by the U.S. Attorney's Office for the Northern District of Illinois related to whether Company sales representatives provided improper gifts or awards to purchasing agents (including government purchasing agents) through the Company's customer loyalty programs. See Note J to the Condensed Consolidated Financial Statements for further information.

The Company announced a cash dividend of \$.20 per common share in the second quarter of 2008, equal to the cash dividend of \$.20 per share announced in the second quarter of 2007.

Cash from operations and a \$75.0 million unsecured revolving line of credit have been sufficient to fund operating requirements, cash dividends and capital expenditures. The Company had \$13.5 million outstanding as of June 30, 2008 under its revolving line of credit. As of June 30, 2008, the Company received a waiver with respect to certain covenants related to EBITDA ratios as defined in the revolving credit agreement. This waiver was necessitated by the \$30.0 million provision made in connection with the settlement of the investigation by the U.S. Attorney's Office. The Company has entered into an amendment to its revolving credit agreement in the third quarter of 2008 modifying certain covenant calculations for the \$30.0 million provision. Cash from operations and the revolving line of credit are also expected to finance the Company's future operations including the remaining settlement payments and costs related to the investigation with the U.S. Attorney's Office.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk at June 30, 2008 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

ITEM 4. CONTROLS AND PROCEDURES

The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report, that the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding financial disclosures.

There was no change in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2008 that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II
OTHER INFORMATION

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

ITEM 1. LEGAL PROCEEDINGS

The information under Note J to the Condensed Consolidated Financial Statements is incorporated herein by reference. The description of the DPA is qualified in its entirety by the actual agreement, which is filed as Exhibit 10 with this Form 10-Q and is incorporated herein by reference.

ITEM 1A. RISK FACTORS

The signing of a Deferred Prosecution Agreement with the U.S. Attorney's Office for the Northern District of Illinois, and any potential breach of such agreement, may adversely affect our business, financial condition, results of operations and stock price.

We have entered into a Deferred Prosecution Agreement (the "DPA") with the U.S. Attorney's Office for the Northern District of Illinois (the "U.S. Attorney's Office"), which provides for the payment of \$30,000,000 in penalties to resolve our liability for the actions of our representatives in improperly providing gifts or awards to purchasing agents through our then-existing customer loyalty programs. The DPA may impact our balance sheet and our ability to borrow funds to pay the penalty. The signing of the DPA may also negatively affect our ability to do business with certain customers (both government and non-government customers). We cannot predict the impact, if any, of the signing of the DPA on our business, financial condition, results of operations, and stock price.

In addition, under the terms of the DPA, if it is determined that we deliberately gave false, incomplete or misleading information under the DPA or have committed any federal crimes subsequent to the DPA, or otherwise knowingly, intentionally, and materially violated any provision of the DPA, we may be subject to prosecution for any federal criminal violation of which the U.S. Attorney's Office has knowledge. For more information on the DPA, see Note J to the Condensed Consolidated Financial Statements filed with this Form 10-Q.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Annual Meeting of Stockholders of Lawson Products, Inc. was held on May 13, 2008. At the Annual Meeting, the stockholders voted on the election of directors and to ratify the appointment of Ernst & Young LLP as the independent registered public accounting firm of Lawson Products, Inc. for the fiscal year ending December 31, 2008. A summary of the votes is as follows:

To elect three directors to serve three years:

<u>Name</u>	<u>For</u>	<u>Withheld Authority</u>
Ronald B. Port, M.D.	7,822,564	62,587
Robert G. Rettig	7,760,204	124,947
Wilma J. Smelcer	7,773,133	112,018

Messrs. Brophy, Postek and Saranow continue to serve as directors of the Company for terms ending in 2009 and Messrs. Errant, Hillman and Neri continue to serve as directors of the Company for terms ending in 2010.

	<u>For</u>	<u>Against</u>	<u>Abstain</u>
Ratification of the Appointment of Ernst & Young LLP as Lawson's independent registered public accounting firm for the fiscal year ending December 31, 2008	7,848,992	34,649	1,510
Approval of the Lawson Products, Inc. Long-Term Incentive Plan	7,056,580	222,278	3,113

ITEM 5. OTHER INFORMATION

The information under Note J to the Condensed Consolidated Financial Statements regarding the Company's entry into the Deferred Prosecution Agreement with the U.S. Attorney's Office for the Northern District of Illinois is incorporated herein by reference. This information would otherwise have been filed under "Item 1.01 Entry into a Material Definitive Agreement" under Form 8-K.

ITEM 6. EXHIBITS

Exhibits

- 10.1 Deferred Prosecution Agreement, dated August 11, 2008.
- 10.2 Eighth Modification of Loan Documents and Covenant Waiver, dated August 6, 2008
- 15 Letter from Ernst & Young LLP Regarding Unaudited Interim Financial Information
- 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

SIGNATURES

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

LAWSON PRODUCTS, INC.
(Registrant)

Dated August 11, 2008

/s/ Thomas J. Neri

Thomas J. Neri
Chief Executive Officer

Dated August 11, 2008

/s/ F. Terrence Blanchard

F. Terrence Blanchard
Chief Financial Officer

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA
v.
LAWSON PRODUCTS, INC.

No.
Judge

DEFERRED PROSECUTION AGREEMENT

Defendant LAWSON PRODUCTS, INC. ("LAWSON PRODUCTS"), a company headquartered in Des Plaines, Illinois, by its undersigned attorneys, pursuant to authority granted by its Board of Directors, and the UNITED STATES OF AMERICA, through PATRICK J. FITZGERALD, United States Attorney for the Northern District of Illinois, enter into this Deferred Prosecution Agreement ("the Agreement"), which shall apply to LAWSON PRODUCTS and all its affiliates and subsidiaries, including Drummond American Corporation and Cronatron Welding Systems, Inc. The terms and conditions of this agreement are as follows:

LAWSON PRODUCTS accepts and acknowledges that, in connection with the execution of this Agreement, the United States will file a one-count criminal Information (attached hereto as Appendix A) in the United States District Court for the Northern District of Illinois. The Information will charge LAWSON PRODUCTS with mail fraud, in violation of 18 U.S.C. § 1341. LAWSON PRODUCTS knowingly and voluntarily waives its right to indictment on this charge, as well as all rights to a speedy trial pursuant to the Sixth Amendment to the United States Constitution, 18 U.S.C. § 3164, and Federal Rule of

Criminal Procedure 48(b). Prosecution of LAWSON PRODUCTS on the charge set forth in the Information shall be deferred for a three-year period. As further provided below, if LAWSON PRODUCTS fully complies with its obligations under this Agreement during the Agreement's three-year term, the United States will dismiss the Information with prejudice.

2. LAWSON PRODUCTS admits, accepts, and acknowledges that it is responsible for the acts of its officers, employees, and sales agents, as set forth in the Information and the Statement of Facts attached as Appendix **B** to this Agreement (the "Statement of Facts"), and that the facts described therein are true and accurate. Should the United States initiate the prosecution that is deferred by this Agreement, LAWSON PRODUCTS agrees that it will neither contest the admissibility of, nor contradict, in any criminal proceeding or civil forfeiture proceeding, the Statement of Facts.

3. LAWSON PRODUCTS agrees to place a total of \$30,000,000 **in** an escrow account to fund the payment of restitution and a civil forfeiture judgment as further set forth below. LAWSON PRODUCTS will fund this escrow account in three equal payments of \$10,000,000. LAWSON PRODUCTS shall make the first \$10,000,000 payment on or before the date that LAWSON PRODUCTS executes this Agreement. LAWSON PRODUCTS shall make its subsequent two \$10,000,000 payments within twelve months and twenty-four months of its execution of this Agreement. At any point, should a controlling interest in LAWSON PRODUCTS be sold, the remaining payments shall be accelerated and due at the closing of that sale.

4. LAWSON PRODUCTS acknowledges that the United States will file a complaint for *in rem* civil forfeiture, which is attached as Appendix C to this Agreement (the "Forfeiture Petition"), for forfeiture of the funds in the escrow account described in paragraph 3. LAWSON PRODUCTS agrees not to contest the forfeiture of this property in the civil forfeiture proceeding. LAWSON PRODUCTS further agrees to the entry of a judgment with respect to the civil forfeiture proceeding. LAWSON PRODUCTS agrees that the funds in the escrow account shall be forfeited and disposed of according to law. LAWSON PRODUCTS and the United States agree that the forfeiture of the funds in the escrow account, once fully funded by LAW SON PRODUCTS pursuant to paragraph 3, shall satisfy all monetary claims by the United States with respect to the civil forfeiture action. Nothing, including a dismissal of the Information or a breach by LAWSON PRODUCTS of this Agreement, shall cause any portion of the funds in the escrow account forfeited pursuant to the civil forfeiture judgment to be refunded. The United States agrees, however, that in the event of a subsequent breach and prosecution, it will recommend to the Court that the amount forfeited pursuant to this Agreement be offset against any monetary penalty the Court may impose as part of its judgment. LAWSON PRODUCTS understands that such a recommendation will not be binding on the Court.

5. LAWSON PRODUCTS acknowledges that if it were convicted of mail fraud, as charged in the information, that it would be obligated to provide restitution to the victims of the scheme, pursuant to 18 U.S.C. § 3663A. The United States and LAWSON

PRODUCTS have agreed that LAWSON PRODUCTS will make restitution payments to customers of LAWSON PRODUCTS that (a) employed individuals who received over \$10,000 in Winners Choice checks; (b) employed individuals who have been or later are convicted of mail fraud as a result of their receipt of Winners Choice checks; or (c) purchased LAWSON PRODUCTS merchandise from sales agents who have been or later are convicted of mail fraud for providing Winners Choice checks to the customers' employees (collectively, "the Victims"). Accordingly, LAWSON PRODUCTS agrees to pay restitution in a total amount of \$806,431, as set out in Appendix D. In making these payments, LAWSON PRODUCTS further agrees to advise the Victims in writing as to the circumstances leading to the payments.

6. LAWSON PRODUCTS hereby represents and warrants that it will not re-employ as an officer or elect as a director any individual who formerly served in either of those positions, and who left such a position with the company on or before the date of this Agreement.

7. This Agreement shall be in effect for three years from the date of its execution (except as provided below in Paragraph 15 of this Agreement, which provides for earlier termination under certain circumstances involving a sale of LAWSON PRODUCTS). During the term of this Agreement, LAWSON PRODUCTS agrees to cooperate fully with the United States Attorney's Office for the Northern District of Illinois and any other authority or agency investigating LAWSON PRODUCTS or any of its present or former

directors, officers, employees, or sales agents, in any and all matters relating to corrupt payments or benefits in connection with its sales or operations. LAWSON PRODUCTS agrees that its cooperation shall include, but not be limited to, the following:

a. LAWSON PRODUCTS shall provide the United States with all documents and records that the United States requests and are not subject to valid claims of attorney-client or work product privileges. The United States shall not assert that any act by LAWSON PRODUCTS known to the United States as of the date of this Agreement constitutes a waiver of its attorney-client or work product privileges in any respect as to matters relating to the scheme described in the Information and Statement of Facts.

b. LAWSON PRODUCTS shall designate knowledgeable present or Former directors, executives, officers, or employees to provide the United States with information regarding matters under investigation that the United States requests. LAWSON PRODUCTS shall use its best efforts to make available for interviews or testimony, as requested by the United States, present or former directors, executives, officers, and employees of LAWSON PRODUCTS or any of its present or former affiliates and subsidiaries. This includes, but is not limited to, sworn testimony before a federal grand jury or in federal trials, as well as interviews with law enforcement authorities. LAWSON PRODUCTS will use its best efforts to ensure that the information that it provides in this manner is complete, truthful, and accurate.

c. With respect to any information, testimony, document, record, or other tangible evidence provided to the United States pursuant to this Agreement, LAWSON PRODUCTS consents to any and all disclosures to other government agencies, including federal and state agencies, of such materials as the United States, in its sole discretion, shall deem appropriate.

8. LAWSON PRODUCTS has implemented and will continue to implement a compliance and ethics program designed to prevent and detect violations of federal and state anti-corruption laws throughout its sales and operations, including those by its affiliates and subsidiaries. LAWSON PRODUCTS has disclosed the components of its compliance and ethics program to the United States. LAWSON PRODUCTS agrees during the term of this Agreement to immediately notify the United States Attorney's Office for the Northern District of Illinois of any violation or suspected violation of federal and state anti-corruption laws that it receives notice of or detects.

9. LAWSON PRODUCTS expressly agrees that it shall not, through its present or future attorneys, directors, executives, officers, or any other person authorized to speak for the company, make any public statement, in litigation or otherwise, contradicting LAWSON PRODUCTS's acceptance of responsibility set forth above or the factual statements set forth in the Statement of Facts. Any such contradictory statement shall constitute a breach of this Agreement as governed by Paragraph 13, and LAWSON PRODUCTS thereafter would be subject to prosecution as set forth in Paragraphs 13 and 14

of this Agreement. The decision of whether any public statement contradicts the Statement of Facts shall be solely that of the United States. Should the United States determine that a public statement by any such person contradicts the Statement of Facts, the United States shall notify LAWSON PRODUCTS. LAWSON PRODUCTS may avoid a breach of this Agreement by publicly repudiating such statement within 48 hours after such notification.

10. If LAWSON PRODUCTS is in full compliance with all of its obligations under this Agreement, the United States, within thirty days of the expiration of the period set forth in paragraph 7 above, will seek dismissal with prejudice of the Information filed against LAWSON PRODUCTS pursuant to Paragraph 1 and this Agreement shall expire.

11. If the United States determines, in its sole discretion, that LAWSON PRODUCTS, at any time between the execution of this Agreement and completion of defendant's cooperation, provided deliberately false, incomplete, or misleading information under this Agreement, has committed any federal or state crime subsequent to the date of this Agreement, or has otherwise violated any provision of this Agreement, LAWSON PRODUCTS shall thereafter be subject to prosecution for any federal criminal violation of which the United States has knowledge. Any such prosecutions may be premised on information provided by LAWSON PRODUCTS, including the Statement of Facts, which shall be admissible at any trial of LAWSON PRODUCTS. Moreover, LAWSON PRODUCTS agrees that any prosecutions that are not time-barred by the applicable statute

of limitations on the date of this Agreement may be commenced against LAWSON PRODUCTS in accordance with this Agreement.

12. Should the United States determine, in its sole discretion, that LAWSON PRODUCTS has, at any time between the execution and termination of this Agreement as set forth in paragraph 7, committed any federal or state crime, provided deliberately false, incomplete, or misleading information under this Agreement, or has otherwise knowingly and willfully breached any other material provision of this Agreement, the United States shall provide written notice to LAWSON PRODUCTS of the alleged breach and provide LAWSON PRODUCTS with a two-week period from receipt of such notice in which to make a presentation to the United States to demonstrate that no federal or state crime was committed, no breach occurred, or, to the extent applicable, that the breach was not material or knowingly and willfully committed or has been cured.

13. In the event that the United States still determines, in its sole discretion and after providing LAWSON PRODUCTS with notice of the alleged breach and an opportunity to make a presentation, that LAWSON PRODUCTS has committed any federal or state crime, provided deliberately false, incomplete, or misleading information under this Agreement, or has otherwise knowingly and willfully breached any other material provision of this Agreement: (a) all statements made by or on behalf of LAWSON PRODUCTS to the United States, the Statement of Facts executed in connection with this Agreement, and any testimony given by LAWSON PRODUCTS before a grand jury, shall be admissible in evidence in any criminal proceeding brought by the United States against LAWSON PRODUCTS, and (b) LAWSON PRODUCTS shall not assert any claim

that any statements made by or on behalf of LAWSON PRODUCTS are inadmissible or should be suppressed.

14. LAWSON PRODUCTS acknowledges that the United States has made no representations, assurances, or promises concerning what sentence may be imposed by the Court should LAWSON PRODUCTS breach this Agreement and this matter proceed to judgment. LAWSON PRODUCTS further acknowledges that any such sentence would be solely within the discretion of the Court and that nothing **in** this Agreement binds or restricts the Court in the exercise of such discretion.

15. LAWSON PRODUCTS agrees that in the event it sells or merges all or substantially all of its business operations as they exist as of the date of this Agreement, whether such sale is structured as a stock or asset sale, it shall include in any contract for sale or merger a provision binding the purchaser or successor to the obligations described in the Agreement; provided, however, that if there should occur a corporate transaction whereby LAWSON PRODUCTS sells substantially all of its assets or engages in a merger or similar transaction whereby LAWSON PRODUCTS is not a surviving corporate entity; and provided the \$30,000,000 obligation and restitution provided for herein in paragraphs 3 and 5 has been paid and satisfied; and further provided that the new entity controlling the former assets or business of LAWSON PRODUCTS is not controlled by a person or entity that has a significant previous affiliation with LAWSON PRODUCTS, then the United States agrees to terminate this Agreement and dismiss the Information within 30 days after the transaction or by August 11, 2009, whichever comes later. In the event that LAWSON PRODUCTS continues in existence following such sale and is not transferring title to any substantial portion of its assets

pursuant to such sale, LAWSON PRODUCTS rather than the purchaser of those assets remains obligated under the Agreement.

16. This Agreement is binding on LAWSON PRODUCTS and the United States Attorney's Office for the Northern District of Illinois, but specifically does not bind any other federal agencies, or any state or local law enforcement or regulatory agencies, although the United States Attorney's Office for the Northern District of Illinois will bring the cooperation of LAWSON PRODUCTS and its compliance with its other obligations under this Agreement to the attention of such agencies and authorities if requested to do so by LAWSON PRODUCTS and its attorneys.

17. This Agreement is entirely voluntary and represents all the terms of the Deferred Prosecution Agreement between LAWSON PRODUCTS and the United States Attorney. No modifications or additions to this Agreement shall be valid unless they are in writing and signed by the United States Attorney, LAWSON PRODUCTS's attorneys, and a duly authorized representative of LAWSON PRODUCTS.

18. Any notice to LAWSON PRODUCTS under this Agreement shall be given by personal delivery, overnight delivery by a recognized delivery service, or registered or certified mail,

addressed to William Heinz, Jenner & Block, 330 North Wabash Avenue, Chicago, IL 60611.

Notice shall be effective upon actual receipt by LAWSON PRODUCTS.

AGREED:

For LAWSON PRODUCTS:

/s/ Thomas J. Neri

THOMAS J. NERI

President and Chief Executive Officer

Lawson Products, Inc.

/s/ William D. Heinz

WILLIAM D. HEINZ

JENNER & BLOCK

Counsel for Lawson Products, Inc.

For the UNITED STATES OF AMERICA:

/s/ Patrick J. Fitzgerald

PATRICK J. FITZGERALD

United States Attorney

/s/ Brandon D. Fox

BRANDON D. FOX

NANCY MILLER

KRUTI TRIVEDI

Assistant United States Attorneys

OFFICER'S CERTIFICATE

I have read this Agreement and carefully reviewed every part of it with counsel for Lawson Products, Inc. ("Lawson Products"). I understand the terms of this Agreement and voluntarily agree, on behalf of Lawson Products, to each of its terms. Before signing this Agreement, I consulted with the attorney for Lawson Products. The attorney fully advised me of Lawson Product's rights, of possible defenses, of the Sentencing Guidelines' provisions, and of the consequences of entering into this Agreement.

I have carefully reviewed this Agreement with the Board of Directors of Lawson Products. I have advised and caused investigative and outside counsel for Lawson Products to advise that Board fully of Lawson Product's rights, of possible defenses, of the Sentencing Guidelines' provisions, and of the consequences of entering into the Agreement. No promises or inducements have been made other than those contained in this Agreement. Furthermore, no one has threatened or forced me or, to my knowledge, any person authorizing this Agreement on behalf of Lawson Products, in any way to enter into this Agreement. I am also satisfied with Lawson Product's representation in this matter.

I certify that I am an officer of Lawson Products and that I have been duly authorized by Lawson Products to execute this Agreement on behalf of Lawson Products and all the subsidiaries named herein.

Lawson Products, Inc.

Date: August 11 , 2008

By: /s/ Thomas J. Neri
THOMAS J. NERI
President and Chief Executive Officer Lawson
Products, Inc.

Appendix A

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA

v.

LAWSON PRODUCTS, INC.

)
)
)
)
)

Violation: Title 18, United States Code,
Sections 1341 and 1346

The UNITED STATES ATTORNEY charges:

1. At times material to this count:

a. Defendant LAWSON PRODUCTS, INC. (“LAWSON PRODUCTS”) was a publicly traded company organized under the laws of the State of Delaware, with its principal offices in Des Plaines, Illinois. Defendant LAWSON PRODUCTS was a distributor and marketer of systems, services and products sold to various entities in the public and private sectors. Defendant LAWSON PRODUCTS was the parent company of several subsidiaries, including Drummond American Corporation and Cronatron Welding- Systems, Inc. Defendant LAWSON PRODUCTS generated approximately \$400 million in sales annually.

b. Defendant LAWSON PRODUCTS had two divisions: maintenance and repair operation (the “MRO business”) and original equipment manufacturing (the “OEM business”). Defendant LAWSON PRODUCTS sold its MRO products through sales agents. These sales agents generally were permitted by defendant LAWSON PRODUCTS to negotiate with its customers over the prices their customers would pay for defendant LAWSON PRODUCTS merchandise. As a general rule, defendant LAWSON PRODUCTS’s profits and the sales agents’ commissions were greater if they sold products at higher prices.

c. Defendant LAWSON PRODUCTS maintained programs for its MRO business through which sales agents could provide items of value to individuals for purchasing defendant LAWSON PRODUCTS merchandise on behalf of those individuals' employers (the "Illicit Programs"). Among the Illicit Programs were Winners Choice, Cavalcade of Awards, LPI, and Spike Special. Defendant LAWSON PRODUCTS administered these Illicit Programs through its Merchandising Department.

d. Defendant LAWSON PRODUCTS and its sales agents often provided a greater amount of rewards through these Illicit Programs if the individuals ordered a greater amount of defendant LAWSON PRODUCTS merchandise on behalf of their employers. Some defendant LAWSON PRODUCTS sales agents received training suggesting that they provide the customers' employees with rewards through the Illicit Programs totaling approximately four to five percent of the amount of the sale.

e. Defendant LAWSON PRODUCTS set up "promotional funds" for each sales agent that allowed defendant LAWSON PRODUCTS and the sales agents to split the cost of the Illicit Programs. When a sales agent's customer ordered merchandise, defendant LAWSON PRODUCTS placed a percentage of the order, based on the amount of commission earned by the sales agent, into the promotional fund, up to a certain maximum dollar amount. A sales agent could then use the promotional fund to pay for at least a portion of the costs of items from the Illicit Programs. The sales agent would pay the remainder of the costs of items from the Illicit Programs out of the commissions the sales agents earned.

Winners Choice

f. Winners Choice was a program in which defendant LAWSON PRODUCTS directed a third-party named Keogh, Inc. (“Keogh”) to issue checks payable to employees of defendant LAWSON PRODUCTS’s customers and to retail stores selected by the recipients of the checks. Keogh would mail these checks to the employees of defendant LAWSON PRODUCTS’s customers, who could then use these checks to purchase items in the designated retail stores. There were several steps that occurred before Keogh would issue these checks:

- i. Cold Certificates. The first step was for sales agents to place orders for “cold certificates” with defendant LAWSON PRODUCTS, which would then inform Keogh of the orders. The sales agents would designate the recipient, the mailing address, the number of cold certificates, and the denomination of the cold certificates. Although the cold certificates were limited to \$10 or \$25 increments, sales agents could order multiple cold certificates totaling far in excess of \$25 to be sent to a recipient.
- ii. Redemption of Cold Certificates. Next, Keogh would ship, via mail or courier, the cold certificates to the recipient at the designated address. Along with the cold certificates, Keogh sent a list of retail stores participating in the Winners Choice program. To redeem the cold certificates, the recipient would fill out an order form by selecting a retail store and the address where Keogh should send the check. The recipient then sent the order form back to Keogh through the mail.
- iii. Checks. Once the recipient had redeemed the cold certificates, Keogh mailed one or more checks, also known as “hot certificates,” to the recipient. While each check was written for \$50 or less, Keogh could mail multiple checks totaling far in excess of \$50 to a recipient. The checks issued by Keogh would list two payees: (1) the individual recipient and (2) the retail store designated by the individual recipient. The individual recipient could then use the checks at the designated retail store.

Cavalcade of Awards and LPI

g. Cavalcade of Awards and LPI were programs in which defendant LAWSON PRODUCTS and its sales agents allowed employees of their customers to select items for themselves from catalogs that were produced by defendant LAWSON PRODUCTS. While the Cavalcade of Awards and LPI programs included items, such as tools, that could be used by customers, the catalogs also contained personal items, such as golf equipment, electronics, and toys. Employees of defendant LAWSON PRODUCTS's customers could select items based upon the amount of "points" or "banque notes" they earned through the amount of purchases the employees caused their employers to make.

Spike Special

h. Spike Special was a program offered at certain times of the year in which Drummond American and its sales agents provided items of value to employees of Drummond American's customers if the employees purchased a certain amount of a specific item on behalf of their employers during the time period that the Spike Special was offered. As with the Cavalcade of Awards and LPI programs, the Spike Special program allowed employees to select items that could be used for their employers, such as tools, or personal items, such as golf equipment, electronics, and toys.

Policies

i. Defendant LAWSON PRODUCTS had a policy that purported to bar sales agents from providing items of value to employees of federal, state, and local government. While this policy existed, defendant LAWSON PRODUCTS did not have any meaningful safeguards in place to detect whether its sales agents were providing items of value to employees of federal, state,

and local government. Additionally, prior to December 15, 2005, defendant LAWSON PRODUCTS generally took no disciplinary action against sales agents it discovered were providing items of value to employees of federal, state, and local government.

j. The employees of defendant LAWSON PRODUCTS customers owed a duty of honest services to their employers, which included the duty to provide their employers with undivided loyalty that was free from conflict of interest between their personal interests and the interests of their employers. Further, many laws and policies existed that prohibited defendant LAWSON PRODUCTS customers from accepting anything of value from vendors in exchange for the customers' business.

2. Beginning no later than 1992 and continuing until approximately December 15, 2005, at Des Plaines and Vernon Hills, in the Northern District of Illinois, and elsewhere, LAWSON PRODUCTS, INC.,

defendant herein, along with others known and unknown, devised and intended to devise, and participated in, a scheme and artifice to defraud defendant LAWSON PRODUCTS's customers of money, property, and the intangible right to the honest services of their employees, and to obtain money and property, by means of materially false and fraudulent pretenses, representations, and promises, as further alleged herein.

3. It was part of the scheme to defraud that from on or about March 11, 1992 through on or about December 15, 2005, defendant LAWSON PRODUCTS provided substantial rewards, including approximately \$9.7 million in Winners Choice checks, to employees of its customers in order to induce them to purchase, and to reward the employees for purchasing, merchandise from LAWSON PRODUCTS on behalf of their employers.

4. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS trained its sales agents how to discuss its Illicit Programs with its customers' employees in order to induce and increase sales.

5. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS taught its sales agents to use the Illicit Programs to minimize customer complaints about pricing and price increases.

6. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS's sales agents occasionally told customers' employees that the Winners Choice certificates were "cash," "non-traceable," "non-taxable," and could not be linked to LAWSON PRODUCTS.

7. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS directed its sales agents and Keogh to send Winners Choice cold certificates and checks to the home addresses of the employees of the customers, rather than the customers' business addresses, to conceal the fact that defendant LAWSON PRODUCTS and its sales agents were providing items of value to its customers' employees.

8. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS sales agents occasionally ordered Winners Choice cold certificates and checks in the names of the spouses of the employees of the customers to conceal the fact that defendant LAWSON PRODUCTS and its sales agents were providing items of value to its customers' employees.

9. It was further part of the scheme to defraud that on occasion employees of defendant LAWSON PRODUCTS's customers misrepresented to their employers that they had not received anything of value from LAWSON PRODUCTS.

10. It was further part of the scheme to defraud that after its sales agents placed an order for Winners Choice cold certificates, defendant LAWSON PRODUCTS redacted the name of the customer from the Winners Choice order forms defendant LAWSON PRODUCTS submitted to Keogh in order to conceal the fact that defendant LAWSON PRODUCTS and its sales agents were providing items of value to the customers' employees.

11. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS, in order to conceal the fact that employees of defendant LAWSON PRODUCTS's customers were receiving benefits through the Illicit Programs, intentionally did not place defendant LAWSON PRODUCTS's name or logo on the Cavalcade of Awards and LPI catalogs.

12. It was further part or the scheme to defraud that defendant LAWSON PRODUCTS knowingly did not issue or file Internal Revenue Form 1099s, as it was required to do, for employees of its customers receiving in excess of \$600 a year from the Illicit Programs.

13. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS improperly deducted the cost of the Illicit Programs as business expenses on its federal tax returns.

14. It was further part of the scheme to defraud that defendant LAWSON PRODUCTS misrepresented, concealed and hid, and caused to be misrepresented, concealed and hidden, the purposes of and acts done in furtherance of the aforementioned scheme.

15. As a result of the scheme, defendant LAWSON PRODUCTS obtained in excess of \$30,000,000 to which it was not entitled.

16. On or about March 2, 2004, at Woodstock, in the Northern District of Illinois,

LAWSON PRODUCTS,

defendant herein, for the purpose of executing the above-described scheme and attempting to do so, knowingly caused to be placed in an authorized depository for mail matter, to be sent and delivered by the United States Postal Service, according to the directions thereon, an envelope from Keogh in Woodstock, Illinois, containing approximately \$1,200 worth of Winners Choice cold certificates, addressed to the spouse of Ronald Gholdson, an employee for defendant LAWSON PRODUCTS's customer Reilly Industries, Inc., at the Gholdsons' home address in Indianapolis, Indiana.

In violation of Title 18, United States Code, Sections 1341 and 1346.

UNITED STATES ATTORNEY

Appendix B
UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA,

V.

NO

LAWSON PRODUCTS, INC.

Judge

STATEMENT OF FACTS

1. LAWSON PRODUCTS, INC. ("LAWSON PRODUCTS") was a publicly traded company organized under the laws of the State of Delaware, with its principal offices in Des Plaines, Illinois. LAWSON PRODUCTS was a distributor and marketer of systems, services and products sold to various entities in the public and private sectors. LAWSON PRODUCTS was the parent company of several subsidiaries, including Drummond American Corporation and Cronatron Welding Systems, Inc. LAWSON PRODUCTS generated approximately \$400 million in sales annually.

2. LAWSON PRODUCTS had two divisions: maintenance and repair operation (the "MRO business") and original equipment manufacturing (the "OEM business"). From at least 1992 through on or about December 15, 2005, LAWSON PRODUCTS's MRO business engaged in corrupt sales practices carried out through its MRO sales agents. These sales agents generally were permitted by LAWSON PRODUCTS to negotiate with its customers over the prices their customers would pay for LAWSON PRODUCTS merchandise. As a general rule, LAWSON PRODUCTS profits and the sales agents' commissions were greater if they sold products at higher prices.

3. LAWSON PRODUCTS maintained programs for its MRO business through which sales agents could provide items of value to individuals for purchasing LAWSON PRODUCTS

merchandise on behalf of those individuals' employers (the "Illicit Programs"). Among the Illicit Programs were Winners Choice, Cavalcade of Awards, LPI, and Spike Special. LAWSON PRODUCTS administered these Illicit Programs through its Merchandising Department until approximately December 15, 2005, when LAWSON PRODUCTS suspended the Illicit Programs.

4. LAWSON PRODUCTS and its sales agents often provided a greater amount of rewards through these Illicit Programs if the individuals ordered a greater amount of LAWSON PRODUCTS merchandise on behalf of their employers. Some LAWSON PRODUCTS sales agents received training suggesting that they provide the customers' employees with rewards through the Illicit Programs totaling approximately four to five percent of the amount of the sale.

5. LAWSON PRODUCTS set up "promotional funds" for each sales agent that allowed LAWSON PRODUCTS and the sales agents to split the cost of the Illicit Programs. When a sales agent's customer ordered merchandise, LAWSON PRODUCTS placed a percentage of the order, based on the amount of commission earned by the sales agent, into the promotional fund, up to a certain maximum dollar amount. A sales agent could then use the promotional fund to pay for at least a portion of the costs of items from the Illicit Programs. The sales agent would pay the remainder of the costs of items from the Illicit Programs out of the commissions the sales agents earned.

6. LAWSON PRODUCTS trained its sales agents how to discuss its Illicit Programs with its customers' employees in order to induce and increase sales. LAWSON PRODUCTS also taught its sales agents to use the Illicit Programs to minimize customer complaints about pricing and price increases.

7. From the inception of the Illicit Programs until December 15, 2005, LAWSON PRODUCTS's sales agents provided items of value of more than a nominal value to purchasing agents for governmental entities in violation of governmental statutes, rules, and regulations concerning procurement. During this same period, LAWSON PRODUCTS's sales agents also provided items of value of more than a nominal value to private entity purchasing agents who accepted the items without the knowledge and consent of their employers and in violation of their employers' procurement policies.

8. In order to conceal the fact that employees of LAWSON PRODUCTS's customers were receiving benefits through the Illicit Programs, LAWSON PRODUCTS intentionally did not place LAWSON PRODUCTS's name or logo on the Cavalcade of Awards and LPI catalogs.

9. LAWSON PRODUCTS had a policy that purported to bar sales agents from providing items of value to employees of federal, state, and local government. While this policy existed, LAWSON PRODUCTS did not have any meaningful safeguards in place to detect whether its sales agents were providing items of value to employees of federal, state, and local government. Additionally, prior to December 15, 2005, LAWSON PRODUCTS generally took no disciplinary action against its sales agents who it discovered were providing items of value to employees of federal, state, and local government. LAWSON PRODUCTS also generally took no disciplinary action against sales agents it discovered were providing items of value to employees of private companies in violation of those private companies' policies.

Winners Choice

10. In approximately late 1991 and early 1992, LAWSON PRODUCTS representatives met with Lawrence Keogh, the President of Keogh, Inc. ("Keogh"), which was in the business of offering an incentive program called Winners Choice ("WC"). LAWSON PRODUCTS decided to use Keogh's WC program as a way to reward the employees of its customers for purchasing LAWSON PRODUCTS merchandise on behalf of their employers.

11. LAWSON PRODUCTS directed Keogh to issue checks payable to employees of LAWSON PRODUCTS's customers and to retail stores selected by the recipients of the checks. Keogh would mail these checks to the employees of LAWSON PRODUCTS 's customers, who could then use these checks to purchase items in the designated retail stores. LAWSON PRODUCTS's sales agents occasionally told customers' employees that the Winners Choice certificates were "cash," "non-traceable," "non-taxable," and could not be linked to LAWSON PRODUCTS.

12. There were several steps that occurred before Keogh would issue these checks:

a. Cold Certificates. The first step was for sales agents to place orders for "cold certificates" with LAWSON PRODUCTS, which would then inform Keogh of the orders. The sales agents would designate the recipient, the mailing address, the number of cold certificates, and the denomination of the cold certificates. Although the cold certificates were limited to \$10 or \$25 increments, sales agents could order multiple cold certificates totaling far in excess of \$25 to be sent to a recipient.

b. Redemption of Cold Certificates. Next, Keogh would ship, via mail or courier, the cold certificates to the recipient at the designated address. Along with the cold certificates, Keogh sent a list of retail stores participating in the Winners Choice program. To

redeem the cold certificates, the recipient would fill out an order form by selecting a retail store and the address where Keogh should send the check. The recipient then sent the order form back to Keogh through the mail.

c. Checks. Once the recipient had redeemed the cold certificates, Keogh mailed one or more checks, also known as “hot certificates,” to the recipient. While each check was written for \$50 or less, Keogh could mail multiple checks totaling far in excess of \$50 to a recipient. The checks issued by Keogh would list two payees: (1) the individual recipient and (2) the retail store designated by the individual recipient. The individual recipient could then use the checks at the designated retail store.

13. LAWSON PRODUCTS directed its sales agents and Keogh to send Winners Choice cold certificates and checks to the home addresses of the employees of the customers, rather than the customers’ business addresses, to conceal the fact that LAWSON PRODUCTS and its sales agents were providing items of value to its customers’ employees. LAWSON PRODUCTS sales agents occasionally ordered Winners Choice cold certificates and checks in the names of the spouses of the employees of the customers to conceal the fact that LAWSON PRODUCTS and its sales agents were providing items of value to its customers’ employees.

14. After its sales agents placed an order for Winners Choice cold certificates, LAWSON PRODUCTS redacted the name of the customer from the Winners Choice order forms that LAWSON PRODUCTS submitted to Keogh in order to conceal the fact that LAWSON PRODUCTS and its sales agents were providing items of value to the customers’ employees.

15. From on or about March 11, 1992 through on or about December 15, 2005, LAWSON PRODUCTS provided approximately \$9.7 million in Winners Choice checks to

employees of its customers in order to induce them to purchase, and to reward the employees for purchasing, merchandise from LAWSON PRODUCTS on behalf of their employers.

Cavalcade of Awards and LPI

16. Cavalcade of Awards and LPI were programs in which LAWSON PRODUCTS and its sales agents allowed employees of their customers to select items for themselves from catalogs that were produced by LAWSON PRODUCTS. While the Cavalcade of Awards and LPI programs included items, such as tools, that could be used by customers, the catalogs also contained personal items, such as golf equipment, electronics, and toys. Employees of LAWSON PRODUCTS's customers could select items based upon the amount of "points" or "banque notes" they earned through the amount of purchases the employees caused their employers to make.

Spike Special

17. Spike Special was a program offered at certain times of the year in which Drummond American and its sales agents provided items of value to employees of Drummond American's customers if the employees purchased a certain amount of a specific item on behalf of their employers during the time period that the Spike Special was offered. As with the Cavalcade of Awards and LPI programs, the Spike Special program allowed employees to select items that could be used for their employers, such as tools, or personal items, such as golf equipment, electronics, and toys.

18. In many instances, LAWSON PRODUCTS provided its customers' employees with income greater than \$600 a year through these Illicit Programs. As a result, LAWSON PRODUCTS was obligated to issue and file Internal Revenue Form 1099s for these individuals. On occasion, Lawrence Keogh suggested to LAWSON PRODUCTS's merchandising department that Keogh

could issue and file CRS Form 1099s for these individuals on behalf of LAWSON PRODUCTS. LAWSON PRODUCTS, however, neither issued nor asked Keogh to issue or file IRS Form 1099s for these individuals.

19. LAWSON PRODUCTS improperly deducted the cost of the Illicit Programs as business expenses on its federal tax returns.

20. On or about March 2, 2004, at Woodstock, in the Northern District of Illinois, LAWSON PRODUCTS, knowingly caused to be placed in an authorized depository for mail matter, to be sent and delivered by the United States Postal Service, according to the directions thereon, an envelope from Keogh in Woodstock, Illinois, containing approximately \$1,200 worth of Winners Choice cold certificates, addressed to the spouse of Ronald Gholdson, an employee for LAWSON PRODUCTS's customer Reilly Industries, Inc., at the Gholdsons' home address in Indianapolis, Indiana.

AGREED:

For LAWSON PRODUCTS:

THOMAS J. NERI
President and Chief Executive Officer Lawson Products, Inc.

WILLIAM D. HEINZ
JENNER & BLOCK
Counsel for Lawson Products, Inc.

Appendix C

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA,

Plaintiff,

v.

FUNDS CONTAINED IN
LASALLE BANK N.A. TRUST NO.
XXXXXX IN THE NAME OF
LAWSON PRODUCTS, INC.

VERIFIED COMPLAINT FOR FORFEITURE

The UNITED STATES OF AMERICA, by PATRICK J. FITZGERALD, United States Attorney for the Northern District of Illinois, for its verified complaint against the above-named defendant property, alleges in accordance with Supplemental Rule (G)(2) of the Federal Rules of Civil Procedure as follows:

1. This complaint for forfeiture is verified by the attached affidavit of Special Agent Brian Murphy of the Federal Bureau of investigation, which is fully incorporated herein.

Jurisdiction and Venue

2. This is an *in rem* forfeiture action brought pursuant to Title 18, United States Code, Section 981(a)(1)(C) for forfeiture of the funds contained in LaSalle Bank N.A. Trust No. XXXXXX in the name of Lawson Products, Inc. (the "Funds"). This Court has jurisdiction over this civil asset forfeiture action pursuant to 28 U.S.C. § 1345 and 1355.

3. This Court has *in rein* jurisdiction over the defendant property pursuant to Title 28, United States Code, Section 1355(b)(1)(A), as certain of the acts giving rise to this forfeiture action occurred within the Northern District of Illinois.

4. Venue is proper under Title 28, United States Code, Section 1395(b) because the Funds are found in this district.

5. This forfeiture action *in rem* is brought pursuant to Title 18, United States Code, Section 981(a)(1)(C).

Specific Allegations

6. There is probable cause to believe that Lawson Products, Inc. committed an offense against the United States, namely, mail fraud, from in or about 1992 to on or about December 15, 2005, in violation of Title 18, United States Code, Section 1341. Specifically, Lawson Products, Inc. provided kickbacks and other illegal rewards to its customers' employees for purchasing Lawson Products, Inc. merchandise on behalf of their employers. As a result of this scheme, Lawson Products, Inc. obtained approximately \$30,000,000 to which it was not entitled.

7. On August 11, 2008, the United States filed an information against Lawson Products, Inc., charging one count of mail fraud. On August 11, 2008, Lawson Products, Inc. and the United States entered into a Deferred Prosecution Agreement. Pursuant to the Agreement, Lawson Products has admitted the factual allegations of the information and the United States has agreed to defer prosecution for the period of three years from the date of the Agreement, provided that Lawson Products, Inc. abide by the conditions and requirements of the Agreement.

8. Further, pursuant to the Agreement, Lawson Products, Inc. agreed to pay to the United States of America a monetary penalty of \$30,000,000, reduced by any restitution payments Lawson Products, Inc. made to victims of its scheme. Lawson Products agreed to place these funds in LaSalle Bank N.A. Trust No. XXXXXX in three annual payments, which are to be accelerated if Lawson Products, Inc. is sold or merged with another company. The parties agreed that the Funds

would be subject to forfeiture in a separately tiled civil complaint. Lawson Products agreed to the entry of a judgment and agreed that the Funds shall be forfeited and disposed of according to law.

9. By reason of the foregoing, there is probable cause to believe that the defendant property constitutes or is derived from proceeds traceable to violations of Title 18, United States Code, Section 1341 (mail fraud), and is subject to forfeiture pursuant to Title 18, United States Code, Section 981(a)(1)(C).

WHEREFORE, the UNITED STATES OF AMERICA prays:

A. That the defendant property be proceeded against for forfeiture and condemnation, that a warrant of seizure and monition issue and that due notice be given to all interested parties to appear and show cause why the forfeiture should not be decreed; and

B. That the court adjudge and decree that the defendant property be forfeited to the United States and disposed of according to law.

Respectfully submitted,

PATRICK J. FITZGERALD
United States Attorney

By: s/Brandon D. Fox
BRANDON D. FOX
Assistant United States Attorney 219 South Dearborn,
Room 500 Chicago, Illinois 60604 (312) 353-5277

NORTHERN DISTRICT OF ILLINOIS

ss
COUNTY OF COOK

AFFIDAVIT OF BRIAN MURPHY

BRIAN MURPHY, being duly sworn under oath, deposes and states as follows:

1. I am a Special Agent with the Federal Bureau of Investigation in Rolling Meadows, Illinois. I have been employed in this capacity for approximately 17 years.

As part of my duties, I have participated in investigations of individuals involved in alleged criminal violations, including mail fraud, wire fraud, and bribery offenses. Through my training and experience and discussion with other law enforcement officers, I am familiar with the methods and practices used by individuals involved in violations of these and other federal and state law as it relates to their financial affairs.

3. I have read the complaint in this matter. The facts alleged are true and correct to the best of my knowledge and belief based upon my own personal knowledge as well as information I have received from other agents, persons, and documents.

4. I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

BRIAN MURPHY, Special Agent
Federal Bureau of Investigation

SUBSCRIBED and SWORN to before me

this _____ day of _____

NOTARY PUBLIC

APPENDIX D

Moog, Inc.	\$ 110,530	
Vertellus	\$ 97,760	07 CR 235
Silberline Manufacturing	\$ 41,195	
Ada S. McKinley Community Services	\$ 28,625	07 CR 234
US Steel	\$ 29,475	
International Paper	\$ 27,625	
Wesley Commons	\$ 23,700	
Cumming, Inc., Nelson Filter Division	\$ 23,325	
Caesar's Palace	\$ 22,925	
ATC/Vancom	\$ 22,000	
Veteran Affairs Medical Center, Buffalo, NY	\$ 21,875	
IGI Labs	\$ 21,550	
Mittal Steel	\$ 21,400	
Victaulic	\$ 21,375	
Wheatland Tube	\$ 20,400	
Humboldt Utilities/Wastewater	\$ 19,625	
United Technologies	\$ 19,475	
ACW Management	\$ 18,325	
Maine Medical Center	\$ 16,850	
Hamilton college	\$ 15,675	
Town of Clay	\$ 15,575	
Michael Stores	\$ 15,195	
Bowdoin College	\$ 14,775	
Lenape Regional High School District	\$ 13,525	
General Motors – Electromotive Division	\$ 12,075	
Foremost Farms, USA Coop	\$ 12,000	
Unit Corp	\$ 11,160	
City of Long Beach	\$ 4,575	07 CR 214
Spaulding County Corrections	\$ 10,550	
Mount Vernon Mills	\$ 10,100	
Illinois School District U-46	\$ 9,875	
Marymount University	\$ 7,555	
Logan County (IL) Housing Authority	\$ 7,475	
Macon County (IL) Highway Department	\$ 4,525	
Mattoon (IL) School District	\$ 4,300	
Chicago Heights (IL) Fire Department	\$ 3,496	07 CR 232
Village of Hazel Crest, IL	\$ 3,600	07 CT 232
Orland Park (IL) Park District	\$ 1,495	07 CR 232
Lincoln (IL) High School	\$ 3,400	
Village of Ramsey, IL	\$ 3,225	
St. Mary's Hospital (Decatur, IL)	\$ 3,225	
City of Blue Island, IL	\$ 3,125	07 CR 234
Dayton Metropolitan Housing Authority	\$ 3,030	
Village of New Lenox, IL	\$ 2,615	07 CR 232
Village of Rosemont, IL	\$ 1,200	
City of Elgin, IL	\$ 1,050	
Total	\$806,431	

EIGHTH MODIFICATION OF LOAN DOCUMENTS AND COVENANT WAIVER
DATED AS OF AUGUST 6, 2008
by and among
Lawson Products, Inc., a Delaware Corporation
AND
BANK OF AMERICA, NATIONAL ASSOCIATION AS SUCCESSOR IN INTEREST
TO LASALLE BANK NATIONAL ASSOCIATION

EIGHTH MODIFICATION OF LOAN DOCUMENTS AND COVENANT WAIVER

THIS EIGHTH MODIFICATION OF LOAN DOCUMENTS AND COVENANT WAIVER (this "Modification") is made as of the 6TH day of August, 2008, by and among Lawson Products, Inc., a Delaware Corporation ("Lawson"), with its principal place of business and chief executive office at 1666 E. Touhy Ave., Des Plaines, Illinois, 60018, various Subsidiaries of Lawson listed on Schedule 6.12 to the Credit Agreement (Lawson and the Subsidiaries may be referred to herein collectively as the "Borrower") and **BANK OF AMERICA, NATIONAL ASSOCIATION**, as successor in interest to LASALLE BANK NATIONAL ASSOCIATION, a national banking association, its successors and assigns ("Lender").

R E C I T A L S:

A. Lender has heretofore made a loan ("Loan") to Borrower in the principal amount of Fifty Million and no/100 Dollars (\$50,000,000) pursuant to the terms and conditions of a Credit Agreement dated as of March 27, 2001 between Borrower and Lender, (the "Credit Agreement", all terms not otherwise defined herein shall have the meanings set forth in the Credit Agreement, as amended), and as evidenced by a Promissory Note dated March 27, 2001, in the principal amount of the Loan made payable by Borrower to the order of Lender ("Note").

B. The Credit Agreement has been amended (i) as of August 12, 2002 to, among other things, add a letter of credit subfacility; (ii) as of July 11, 2003 to, among other things, increase the availability under the letter of credit subfacility; (iii) as of May 31, 2005 to, among other things, increase the Maximum Facility, (iv) as of November 30, 2006 to, among other things, modify the interest rate to be charged on the facility; (v) as of January 31, 2007 to, among other things, acknowledge Lawson's liquidation and dissolution Assembly Component Systems, Limited, a United Kingdom corporation ("ACSL"), a Subsidiary of Lawson, and therefore release ACSL from the facility; (vi) as of June 21, 2007 to, among other things, increase the letter of credit subfacility and modify certain financial covenants; and (vii) as of December 26, 2007 to, among other things, increase certain subfacilities and to modify certain financial covenants.

C. On or about July 31, 2008, the Borrower reached a settlement agreement (the "Federal Settlement") with the United States of America resulting from an ongoing investigation of certain "gifting" practices of employees and sales agents of the Borrower. Pursuant to the Federal Settlement, the Borrower will pay the aggregate principal amount of \$30,000,000 ("Federal Settlement Amount") to settle all claims of the United States of America relating to the "gifting" practices. The Federal Settlement Amount will be payable by the Borrower in three (3) annual installments with the first payment to be made in August, 2008; notwithstanding the foregoing, the Federal Settlement Amount, and certain costs and expenses relating thereto, will be reserved for by the Borrower for accounting purposes in the Fiscal Quarter ending June 30, 2008.

D. Borrower has requested that the Credit Agreement be further modified in order to waive certain covenant violations that will result from the accounting reserve of the Federal Settlement, to modify certain financial covenants to accommodate the payment and accounting reserve of the Federal Settlement Amount and certain other costs and expenses relating thereto, and for the other purposes hereinafter set forth, and the Lender has agreed modify those subfacilities upon the terms and conditions hereinafter set forth.

AGREEMENTS:

NOW, THEREFORE, in consideration of (i) the facts set forth hereinabove (which are hereby incorporated into and made a part of this Modification with the intent that Lender may rely upon the matters therein recited as representations and warranties of Borrower), (ii) the Credit Agreements by Lender to modify the Loan Documents, as provided herein, (iii) the covenants and agreements contained herein, and (iv) for other good and valuable consideration, the receipt, adequacy and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. **Waiver of Events of Default and Defaults.** Borrower acknowledges and agrees as follows:

(a) **Acknowledgment of Events of Default.** That (i) as of the Fiscal Quarter ending June 30, 2008, the Borrower has, as a result of the Federal Settlement Amount, suffered Events of Default (x) of the Fixed Charge Coverage Ratio set forth in Section 8.13(C) and (y) of the a ratio of consolidated Total Debt to consolidated EBITDA set forth in Section 8.13(G) (for purposes hereof, together, the "Existing Default"), and as a result Events of Default and Defaults exist and continue to exist under the Credit Agreement; (ii) all grace periods, if any, applicable to the cure of the Existing Default have expired; and (iii) Lender has not previously waived in any respect their right to demand acceleration of the Loan and/or bring remedial action against the Borrower on account of the Existing Default.

(b) **Acknowledgment of Obligations and Borrower' Liability Thereon.** That (i) Borrower is indebted to the Lender as of the effective date of this Modification as set forth in the Credit Agreement; and (ii) as a result of the Existing Default the outstanding principal balance of the Loan, if called by the Lender, would be due and payable in full, without offset, deduction or counterclaim of any kind or character whatsoever, and is subject to increase, decrease or other adjustment as the result of any and all interest, fees and other reasonable charges including, without limitation, reasonable attorneys' fees and costs of collection, which are payable under the Loan Documents.

(c) **Acknowledgment that Obligations Continue in Full Force and Effect.** That the Note and all other liabilities and obligations of Borrower to the Lender under the Note, the Credit Agreement and all of the other Loan Documents shall remain in full force and effect, and shall not be released, impaired, diminished or in any other way modified or amended as a result of the execution and delivery of this Modification except as otherwise specifically provided herein.

(d) **Waiver of Default.** The Borrower has requested that Lender waive the Existing Default, and pursuant to this Modification, Lender has agreed to waive the Existing Default. Except as and to the limited extent otherwise expressly provided herein with respect to the Existing Default, nothing in this Modification shall be construed as a waiver by the Lender of any promises, covenants, conditions or obligations of the Borrower under the Loan Documents or as a waiver by the Lender of any other past, present or future Unmatured Event of Default or Event of Default.

(e) **Release.** The Borrower hereby acquits, and forever discharges the Lender and each and every past and present subsidiary, affiliate, stockholder, officer, director, agent, servant, employee, representative, and attorney of the Lender from any and all claims, causes of action, suits, debts, liens, obligations, liabilities, demands, losses, costs and expenses (including reasonable attorneys' fees) of any kind, character, or nature whatsoever, known or unknown, fixed or contingent, which the Borrower may have or claim to have now or which may hereafter arise out of or be connected with any act of commission or omission of the Lender existing or occurring prior to the date of this Modification or any instrument executed prior to the date of this Modification including, without limitation, any claims, liabilities or obligations arising with respect to the indebtedness evidenced by the Note or any of the other Loan Documents. The provisions of this Section 1 of this Modification shall be binding upon the Borrower and their respective heirs, executors and administrators and shall inure to the benefit of the Lender, and its successors and assigns, and shall survive the termination of the Loan Documents.

2. **Modification to the calculation of certain financial covenants for a limited period.** Borrower has reserved for accounting purposes the Federal Settlement Amount in its Fiscal Quarter ending June 30, 2008. For purposes of calculating the Fixed Charge Coverage Covenant set forth in Section 8.13(C) of the Credit Agreement, and the Total Debt to consolidated EBITDA covenant set forth in Section 8.13(G) of the Credit Agreement, the Federal Settlement Amount plus the additional sum of \$5,000,000 for costs and expenses relating to the Federal Settlement Amount shall not be classified as a reduction to EBITDA for the applicable measurement periods. After the Fiscal Quarter ending June 30, 2008 has, on a rolling Fiscal Quarter basis, ceased being a part of the financial covenants described above, this modification to EBITDA shall be of no force or effect. In addition to the foregoing, and notwithstanding the modification to EBITDA, the Federal Settlement Amount shall be added to the calculation of Total Debt for each Fiscal Quarter of the Borrower until the entire Federal Settlement Amount has been paid in full by the Borrower to the United States of America.

3. **Representations and Warranties of Borrower.** Borrower hereby represents, covenants and warrants to Lender as follows:

(a) The representations and warranties in the Credit Agreement, and the other Loan Documents are true and correct as of the date hereof.

(b) There is currently no Default under the Note, the Credit Agreement or the other Loan Documents and Borrower does not know of any event or circumstance which would constitute a Default under the Note, the Credit Agreement or the other Loan Documents.

(c) The Loan Documents are in full force and effect and, following the execution and delivery of this Modification, they continue to be the legal, valid and binding obligations of Borrower enforceable in accordance with their respective terms, subject to limitations imposed by general principles of equity.

(d) There has been no material adverse change in the financial condition of Borrower or any other party whose financial statement has been delivered to Lender in connection with the Loan from the date of the most recent financial statement received by Lender.

(e) As of the date hereof, Borrower has no claims, counterclaims, defenses, or set-offs with respect to the Loan or the Loan Documents as modified herein.

(f) Borrower is validly existing under the laws of the State of its formation or organization and has the requisite power and authority to execute and deliver this Modification and to perform the Loan Documents as modified herein. The execution and delivery of this Modification and the performance of the Loan Documents as modified herein have been duly authorized by all requisite action by or on behalf of Borrower. This Modification has been duly executed and delivered on behalf of Borrower.

4. **Conditions Precedent.** The Credit Agreement of Lender to amend the Loan Documents as set forth herein is subject to the following conditions precedent:

(a) Lender shall have received this Modification duly executed by an authorized individual for each entity that is a party hereto.

(b) Lender shall have received resolutions of each Borrower approving the execution of this Modification in form and content acceptable to Lender.

(c) Borrower shall pay all out-of-pocket costs and expenses incurred by Lender in connection with this Modification, including, without limitation, title charges, recording fees, appraisal fees and attorneys' fees and expenses.

(d) Lender shall have received a confirmation of receipt and agreement to proceed with the Term Sheet proposal from the Lender dated as of July 30, 2008.

(d) Lender shall have received such other documents as may be reasonably requested by Lender or its counsel.

5. **Miscellaneous.**

(a) This Modification shall be governed by and construed in accordance with the laws of the State of Illinois.

(b) This Modification shall not be construed more strictly against Lender than against Borrower merely by virtue of the fact that the same has been prepared by counsel for Lender, it being recognized that Borrower and Lender have contributed substantially and materially to the preparation of this Modification, and Borrower and Lender each acknowledges and waives any claim contesting the existence and the adequacy of the consideration given by the other in entering into this Modification. Each of the parties to this Modification represents that it has been advised by its respective counsel of the legal and practical effect of this Modification, and recognizes that it is executing and delivering this Modification, intending thereby to be legally bound by the terms and provisions thereof, of its own free will, without promises or threats or the exertion of duress upon it. The signatories hereto state that they have read and understand this Modification, that they intend to be legally bound by it and that they expressly warrant and represent that they are duly authorized and empowered to execute it.

(c) Notwithstanding the execution of this Modification by Lender, the same shall not be deemed to constitute Lender a venturer or partner of or in any way associated with Borrower nor shall privity of contract be presumed to have been established with any third party.

(d) Borrower and Lender each acknowledges that there are no other understandings, agreements or representations, either oral or written, express or implied, that are not embodied in the Loan Documents and this Modification, which collectively represent a complete integration of all prior and contemporaneous agreements and understandings of Borrower and Lender; and that all such prior understandings, agreements and representations are hereby modified as set forth in this Modification. Except as expressly modified hereby, the terms of the Loan Documents are and remain unmodified and in full force and effect.

(e) This Modification shall bind and inure to the benefit of the parties hereto and their respective heirs, executors, administrators, successors and assigns.

(f) Any references to the "Note", the "Credit Agreement," or the "Loan Documents" contained in any of the Loan Documents shall be deemed to refer to the Note, Credit Agreement and the other Loan Documents as amended hereby. The paragraph and section headings used herein are for convenience only and shall not limit the substantive provisions hereof. All words herein which are expressed in the neuter gender shall be deemed to include the masculine, feminine and neuter genders. Any word herein which is expressed in the singular or plural shall be deemed, whenever appropriate in the context, to include the plural and the singular.

(g) This Modification may be executed in one or more counterparts, all of which, when taken together, shall constitute one original Agreement.

(h) Time is of the essence of each of Borrower's obligations under this Modification.

(i) Customer Identification — USA Patriot Act Notice. The Lender hereby notifies the Borrower that pursuant to the requirements of the USA Patriot Act (Title III of Pub. L. 107-56, signed into law October 26, 2001) (the “Act”), and the Lender’s policies and practices, the Lender is required to obtain, verify and record certain information and documentation that identifies the Borrower, which information includes the name and address of the Borrower and such other information that will allow the Lender to identify the Borrower in accordance with the Act.

(Signature Page Follows)

IN WITNESS WHEREOF, the parties hereto have executed this Modification dated as of the day and year first above written

LASALLE BANK NATIONAL
ASSOCIATION (as Lender)

By: /s/ David Bacon
Name: David Bacon
Its: Vice President

LAWSON PRODUCTS, INC., a Delaware Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS, INC., a Georgia Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS, INC., a New Jersey Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS, INC., a Nevada Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS, INC., a Texas corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS, INC., a Canadian Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LP SERVICE CO., an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LPI HOLDINGS, INC., an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

CRONATRON WELDING SYSTEMS, INC., a North Carolina Corporation (as
Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

DRUMMOND AMERICAN Corporation, an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

ASSEMBLY COMPONENT SYSTEMS, INC., an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

AUTOMATIC SCREW MACHINE PRODUCTS COMPANY, INC., an Alabama Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

C.B. LYNN COMPANY, an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LP INDUSTRIAL PRODUCTS COMPANY, an Illinois Corporation (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

LAWSON PRODUCTS DE MEXICO, S.A. DE C.V. (as Borrower)

By: /s/ Thomas Neri
Thomas Neri
Its: Chief Executive Officer

August 11, 2008

Board of Directors
Lawson Products, Inc.

We are aware of the incorporation by reference in the Registration Statement (Form S-8 no. 33-17912 dated November 4, 1987) of Lawson Products, Inc. and subsidiaries of our report dated August 11, 2008 relating to the review of the condensed consolidated balance sheet of Lawson Products, Inc. and subsidiaries as of June 30, 2008, and the related condensed consolidated statements of operations for the three and six month periods ended June 30, 2008 and 2007 and the condensed consolidated statements of cash flows for the six month period ended June 30, 2008 and 2007, which are included in the Form 10-Q for the quarter ended June 30, 2008.

Pursuant to Rule 4369(c) of the Securities Act of 1933 our report is not part of the registration statement prepared or certified by accountants within the meaning of Section 7 or 11 of the Securities Act of 1933.

/s/ ERNST & YOUNG LLP

Chicago, Illinois

CERTIFICATIONS

I, Thomas J. Neri, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lawson Products, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 11, 2008

/s/ Thomas J. Neri

Thomas J. Neri
Chief Executive Officer

CERTIFICATIONS

I, F. Terrence Blanchard, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lawson Products, Inc. (the “registrant”);
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;
 - (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 11, 2008

/S/ F. Terrence Blanchard

F. Terrence Blanchard
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350 AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Lawson Products, Inc. (the "Company") on Form 10-Q for the period ending June 30, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Chief Executive Officer and Chief Financial Officer of the Company hereby certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002 that based on their knowledge: (1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the periods covered in the Report.

August 11, 2008

/s/ Thomas J. Neri

Thomas J. Neri
Chief Executive Officer

/s/ F. Terrence Blanchard

F. Terrence Blanchard
Chief Financial Officer