

LOCKHEED MARTIN CORP
Form 4
August 15, 2008

FORM 4

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

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Comey James B

2. Issuer Name and Ticker or Trading Symbol
LOCKHEED MARTIN CORP
[LMT]

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

(Last) (First) (Middle)
6801 ROCKLEDGE DRIVE
(Street)

3. Date of Earliest Transaction (Month/Day/Year)
08/13/2008

____ Director _____ 10% Owner
 Officer (give title below) _____ Other (specify below)
Senior VP & General Counsel

BETHESDA, MD 20817

4. If Amendment, Date Original Filed(Month/Day/Year)

6. Individual or Joint/Group Filing(Check Applicable Line)
 Form filed by One Reporting Person
 Form filed by More than One Reporting Person

(City) (State) (Zip)

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1. Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)	5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price
Common Stock	08/13/2008		M		13,333	A	\$ 67.97
Common Stock	08/13/2008		S		13,333	D	\$ 114 0
Common Stock					386.8268	I	

Lockheed Martin Salaried Savings Plan

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474
(9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(e.g., puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)	Amount or Number of Shares
Employee Stock Option (Right to Buy)	\$ 67.97	08/13/2008		M	13,333	<u>(1)</u> 02/01/2016	Common Stock	13,333

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Comey James B 6801 ROCKLEDGE DRIVE BETHESDA, MD 20817			Senior VP & General Counsel	

Signatures

James B. Comey, by Marian S. Block,
Attorney-in-Fact 08/15/2008

__Signature of Reporting Person Date

Explanation of Responses:

- * If the form is filed by more than one reporting person, see Instruction 4(b)(v).
- ** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. See 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).
- (1) The options vest over three years, one-third on each of the first, second and third anniversaries of the grant date, beginning on February 1, 2007.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, see Instruction 6 for procedure. Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. e Company is restricted from withdrawing this balance without the prior consent of the outside party during the term of the agreement. The adoption of ASU 2016-18 does not materially affect the accounting for restricted cash of the Company.

Note 4 — Inventories, net

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

	(Dollars in thousands)	
	September 30, 2018	December 31, 2017
Inventories, gross	\$56,602	\$56,492
Reserve for obsolete and excess inventory	(5,448)	(5,564)
Inventories, net	\$51,154	\$50,928

Note 5 — Acquisition

In October 2017, the Company acquired Bolt Supply, based in Calgary, Canada, for a purchase price of approximately \$32.3 million. The purchase price was funded with cash on hand and utilization of Lawson Products' existing credit facility. Bolt Supply is a leading Canadian distributor of high quality fasteners, power tools and industrial MRO supplies, with 13 branch locations throughout Alberta, Saskatchewan, and Manitoba, Canada at the end of the third quarter 2018.

The purchase price of the acquisition was allocated to the fair market value of Bolt Supply's assets and liabilities on the acquisition date. The fair market value appraisals of the majority of the assets and liabilities were determined by third party valuation firms including intangible assets of \$7.2 million for trade names and \$4.2 million for customer relationships, respectively. The trade names and customer relationships intangible assets have estimated useful lives of 15 and 12 years, respectively. The \$14.0 million allocated to goodwill reflects the purchase price less the fair market value of the identifiable net assets. The fair values of the assets acquired and liabilities assumed, and the related tax balances, are based on estimates and assumptions. Further operating details related to the operations of Bolt Supply subsequent to the acquisition are included in Note 14 - Segment information.

The following table contains unaudited pro forma revenue and net income (loss) for Lawson Products assuming the Bolt Supply acquisition closed on January 1, 2016.

	(Dollars in thousands)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue				
Actual	\$88,530	\$75,651	\$263,371	\$225,274
Pro forma	88,530	85,156	263,371	250,781
Net income (loss)				
Actual	\$(816)	\$1,321	\$3,614	\$9,451
Pro forma	(816)	1,534	3,614	10,175

The pro forma disclosures in the table above include adjustments for, amortization of intangible assets and acquisition costs to reflect results as if the acquisition of Bolt Supply had closed on January 1, 2016 rather than on the actual acquisition date. This pro forma information utilizes certain estimates, is presented for illustrative purposes only and is not intended to be indicative of the actual results of operation. In addition, future results may vary significantly from the results reflected in the pro forma information. The unaudited pro forma financial information does not reflect the impact of future positive or negative events that may occur after the acquisition, such as anticipated cost savings from operating synergies.

Table of Contents

Note 6 - Goodwill

Goodwill activity for the first nine months of 2018 and 2017 is included in the table below:

	(Dollars in thousands)	
	Nine Months Ended September 30,	
	2018	2017
Beginning balance	\$19,614	\$5,520
Adjustment to original acquisition allocation	(17)	(73)
Impact of foreign exchange	(483)	342
Ending balance	\$19,114	\$5,789

Note 7 - Intangible assets

The gross carrying amount and accumulated amortization by intangible asset class were as follows:

	(Dollars in thousands)			(Dollars in thousands)		
	September 30, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Trade names	\$7,994	\$ (1,341)	\$ 6,653	\$8,182	\$ (957)	\$ 7,225
Customer relationships	4,785	(537)	4,248	4,911	(323)	4,588
	\$12,779	\$ (1,878)	\$ 10,901	\$13,093	\$ (1,280)	\$ 11,813

Amortization expense of \$0.7 million and \$0.2 million related to intangible assets was recorded in General and administrative expenses for the nine months ended September 30, 2018 and 2017, respectively.

Note 8 — Loan Agreement

Lawson Loan Agreement

In 2012, the Company entered into a Loan and Security Agreement (“Loan Agreement”). The Loan Agreement consists of a \$40.0 million revolving line of credit facility, which includes a \$10.0 million sub-facility for letters of credit. Certain terms of the original Loan Agreement have been revised by subsequent amendments.

The Loan Agreement, as amended, expires in August 2020. Due to the lock box arrangement and a subjective acceleration clause contained in the Loan Agreement, any outstanding borrowings under the revolving line of credit are classified as a current liability.

Currently, credit available under the Loan Agreement, as amended, is based upon:

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

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

At September 30, 2018, the Company had \$8.4 million of borrowings under its revolving line of credit facility and additional borrowing availability of \$27.0 million. The Company paid interest of \$0.8 million and \$0.4 million for the nine months ended September 30, 2018 and 2017, respectively. The weighted average interest rate was 3.82% for the nine months ended September 30, 2018 and 3.91% for the nine months ended September 30, 2017.

Table of Contents

In addition to other customary representations, warranties and covenants, the Company is required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement, if the excess borrowing capacity is below \$10.0 million. On September 30, 2018, the Company's borrowing capacity exceeded \$10.0 million. Therefore, the Company was not subject to this financial covenant, however, for informational purposes the result of the financial covenant is provided below:

Quarterly Financial Covenant	Requirement	Actual
EBITDA to fixed charges ratio	1.10 : 1.00	3.60 : 1.00

Commitment Letter

Bolt Supply has a Commitment Letter with BMO Bank of Montreal ("BMO") dated March 30, 2017 which allows Bolt Supply to access up to \$5.5 million Canadian dollars in the form of either an overdraft facility or as commercial letters of credit. The Commitment Letter is cancellable at any time at BMO's sole discretion and is secured by substantially all of Bolt Supply's assets. It carries an interest rate of the bank's prime rate plus 0.25%. At September 30, 2018, Bolt Supply had \$2.0 million Canadian dollars of outstanding borrowings and remaining borrowing availability of \$3.5 million Canadian dollars. The Commitment Letter is subject to a working capital ratio of 1.35:1, a maximum ratio of debt to tangible net worth of 2.5:1 of the Bolt Supply assets and Debt Service Coverage Ratio 1.25:1 as defined in the Commitment Letter. At September 30, 2018, Bolt Supply was in compliance with all covenants which are subject to periodic review, at least annually, with the next review due by August 31, 2019.

Note 9 — Severance Reserve

Changes in the Company's reserve for severance as of September 30, 2018 and 2017 were as follows:

	(Dollars in thousands)	
	Nine Months Ended	
	September 30,	
	2018	2017
Balance at beginning of period	\$483	\$1,710
Charged to earnings	723	595
Payments	(787)	(1,625)
Balance at end of period	\$419	\$680

Note 10 — Stock-Based Compensation

The Company recorded stock-based compensation expense of \$8.7 million and \$2.7 million for the first nine months of 2018 and 2017, respectively. A portion of stock-based compensation is related to the change in the market value of the Company's common stock.

A summary of stock-based awards activity during the nine months ended September 30, 2018 follows:

Stock Performance Rights ("SPRs")

The Company issued 44,737 SPRs to key employees with an exercise price of \$24.70 per share that cliff vest on December 31, 2020 and have a termination date of December 31, 2025.

Restricted Stock Awards ("RSAs")

The Company issued 26,080 RSAs to members of the Company's Board of Directors with a vesting date of May 15, 2019 and issued 20,059 RSAs to key employees that cliff vest on December 31, 2020. Each RSA is exchangeable for

Explanation of Responses:

one share of the Company's common stock at the end of the vesting period.

Market Stock Units ("MSUs")

The Company issued 32,194 MSUs to key employees that cliff vest on December 31, 2020. MSU's are exchangeable for the Company's common stock at the end of the vesting period. The number of shares of common stock that will be issued upon vesting, ranging from zero to 48,291, will be determined based upon the trailing sixty-day weighted average closing price of the Company's common stock on December 31, 2020.

12

Table of Contents

For the three months ended September 30, 2018, the effect of restricted stock awards, market stock units and future stock option exercises equivalent of approximately 403,000 shares was excluded from the computation of diluted earnings per share because they would have been anti-dilutive. For the nine months ended September 30, 2018, stock options to purchase approximately 46,000 shares of the Company's common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive.

For the three and nine months ended September 30, 2017, stock options to purchase approximately 80,000 and 67,000 shares, respectively, of the Company's common stock were excluded from the computation of diluted earnings per share because they were anti-dilutive.

Note 11 — Income Taxes

The Company recorded income tax expenses of \$0.4 million, a 10.8% effective tax rate for the nine months ended September 30, 2018. The effective tax rate is lower than the U.S. statutory rate due mainly to discrete items such as the finalization of our calculation for previously untaxed foreign earnings and profits. The Securities and Exchange Commission ("SEC") recently issued SAB 118 (Income Tax Accounting Implications of the Tax Cuts and Jobs Act) which allows registrants to record provisional amounts during a measurement period. The SAB allows a company to recognize provisional amounts when it does not have the necessary information prepared in reasonable detail to calculate the effect of the change in tax law. Per the SAB, a company should report provisional amounts when the accounting is not complete, but for which a reasonable estimate can be determined. Lawson included in its 2017 taxable income calculation a provisional amount of approximately \$8.4 million representing previously untaxed foreign earnings and profits as of December 31, 2017. The Company did not accrue any federal income tax on this amount as the Company is able to utilize federal net operating losses to offset the income. The Company recently finalized the foreign earnings and profits calculation in conjunction with the finalization of 2017 federal income tax return when all required necessary information was more readily available. A lower final foreign earnings and profits inclusion resulted in a tax benefit which had a beneficial impact on the effective tax rate for the nine months ended September 30, 2018. Excluding the discrete items, the Company's effective tax rate was 33.5% for the nine months ended September 30, 2018. An income tax expense of \$0.8 million was recorded for the nine months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

The Company and its subsidiaries are subject to U.S. Federal income tax, as well as income tax of multiple state and foreign jurisdictions. As of September 30, 2018, the Company is subject to U.S. Federal income tax examinations for the years 2015 through 2017 and income tax examinations from various other jurisdictions for the years 2011 through 2017.

Earnings from the Company's foreign subsidiaries are considered to be indefinitely reinvested. A distribution of these non-U.S. earnings in the form of dividends or otherwise may subject the Company to foreign withholding taxes and U.S. federal and state taxes.

Note 12 — Contingent Liabilities

In 2012, the Company identified that a site it owns in Decatur, Alabama, contains hazardous substances in the soil and groundwater as a result of historical operations prior to the Company's ownership. The Company retained an environmental consulting firm to further investigate the contamination including the measurement and monitoring of the site and the site was enrolled in the Alabama Department of Environmental Management ("ADEM") voluntary cleanup program.

As of December 31, 2017, the Company had received estimates from its environmental consulting firm for two remediation solutions based on a chemical injection process. The first solution consisted of chemical injections

throughout the entire site to directly eliminate the hazardous substances in the soil and groundwater. The second solution consisted of chemical injections around the perimeter of the site to prevent the migration of the hazardous chemicals off-site. Neither solution required additional excavation or repairs to be made to the property. The estimated expenditures over an 18 month period under the two injection scenarios ranged from \$0.9 million to \$2.0 million. The Company had determined that it would initially proceed with the method of injecting chemicals around the perimeter of the site to prevent the migration of the hazardous chemicals off-site. As of December 31, 2017, approximately \$1.0 million remained accrued for this remediation.

In June 2018, the Company received updated environmental remediation estimates from its environmental consulting firm based on information analyzed from further data collection and consultation with ADEM on their anticipated requirements. The updated remediation plan expands the chemical injection process over a larger area than previously estimated, including under the building on the property. The updated plan also requires four consecutive quarters of monitoring the affected area after the injection process is completed. Based upon feedback received from ADEM, the Company accrued an additional \$0.5 million of expense in the second quarter of 2018 to bring the total liability to \$1.4 million which represents the most likely outcome. This

Table of Contents

plan is expected to be approved by ADEM with remediation efforts commencing in the first quarter of 2019. The Company believes the environmental remediation liability of \$1.4 million currently accrued will be sufficient to cover the cost of the plan. The Company does not expect to capitalize any amounts related to the remediation plan.

Note 13 — Lease Termination

In the first quarter of 2012, the Company signed a 10 year agreement to lease space for a new corporate headquarters in Chicago, Illinois ("Lease"). In the fourth quarter of 2013, due to excess capacity as a result of a corporate restructuring, the Company agreed to sublease a portion (approximately 17,100 square feet) of its corporate headquarters to a third party ("Sublease"). Both the Lease and the Sublease were scheduled to terminate in the first quarter of 2023.

In the second quarter of 2018, the Company entered into agreements with the lessor and the sub lessee to terminate both the Lease and Sublease in June 2019. The original loss recorded on the Sublease was reduced by \$0.7 million in the second quarter of 2018 to reflect the shortened lease time frame. Additionally, the Company is required to pay a \$0.5 million fee before June 2019 as a condition of early termination of the original Lease. As a result of these transactions, a \$0.2 million net gain was recognized in the second quarter of 2018. The \$0.5 million early termination fee is included in current liabilities in the condensed consolidated balance sheet.

The termination of the Lease will reduce the Company's future operating lease obligation by \$1.2 million, offset by a reduction in future payments from the Sublease of \$0.4 million.

Table of Contents

Note 14 – Segment Information

With the acquisition of Bolt Supply in the fourth quarter of 2017, the Company operates in two reportable segments. The businesses were determined to be separate reportable segments because of differences in their financial characteristics and the methods they employ to deliver product to customers. The operating segments are reviewed by the Company's chief operating decision maker responsible for reviewing operating performance and allocating resources. The Lawson segment primarily relies on its large network of sales representatives to visit the customer at the customers' work location and provide VMI service and produce sales orders for product that is then shipped to the customer. The Bolt Supply segment primarily sells product to customers through its branch locations. Bolt Supply had 13 branches in operation at the end of the third quarter 2018.

Financial information for the Company's reportable segments follows:

	(Dollars in thousands)			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue				
Lawson product revenue	\$68,539	\$75,651	\$206,108	\$225,274
Lawson service revenue	10,153	—	29,627	—
Total Lawson revenue	78,692	75,651	235,735	225,274
Bolt Supply	9,838	—	27,636	—
Consolidated total	\$88,530	\$75,651	\$263,371	\$225,274
Gross profit				
Lawson product gross profit	\$37,742	\$46,005	\$113,291	\$136,025
Lawson service gross profit	6,710	—	19,380	—
Total Lawson gross profit	44,452	46,005	132,671	136,025
Bolt Supply	3,656	—	10,786	—
Consolidated total	\$48,108	\$46,005	\$143,457	\$136,025
Operating income (loss)				
Lawson	\$(2,955)	\$1,090	\$3,062	\$9,693
Bolt Supply	689	—	2,063	—
Consolidated total	(2,266)	1,090	5,125	9,693
Interest expense	(251)	(133)	(755)	(393)
Other income (expense), net	170	843	(320)	953
Income (loss) before income taxes	\$(2,347)	\$1,800	\$4,050	\$10,253

Note 15 - Subsequent Events

On October 1, 2018, the Company completed the purchase of Screw Products, Inc., an industrial parts distributor for approximately \$5.2 million which was paid in cash at the time of closing. Screw Products has a location in Dallas, Texas and a location in Dayton, Ohio.

Table of Contents

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

Overview

The Maintenance, Repair and Operations ("MRO") distribution industry is highly fragmented. We compete for business with several national distributors as well as a large number of regional and local distributors. The MRO business is significantly impacted by the overall strength of the manufacturing sector of the U.S. economy. One measure used to evaluate the strength of the industrial products market is the PMI index published by the Institute for Supply Management, which is considered by many economists to be a reliable near-term economic barometer of the manufacturing sector. A measure above 50 generally indicates expansion of the manufacturing sector while a measure below 50 generally represents contraction. The average monthly PMI was 60.4 in the third quarter of 2018 compared to 58.7 in the third quarter of 2017, indicating a strong U.S. manufacturing economy.

Our sales are also affected by the number of sales representatives and their productivity. Our sales force consisted of an average of 967 and 991 sales representatives during the third quarters of 2018 and 2017, respectively. Our Lawson segment sales rep productivity, measured as sales per rep per day, increased 6.6% to \$1,292 in the third quarter of 2018 from \$1,212 in the third quarter of 2017. We anticipate moderate growth in the size of our sales force for the remainder of 2018 as we concentrate our efforts on providing training and support to continue to increase the productivity of our existing sales representatives.

In the fourth quarter of 2017 the Company acquired The Bolt Supply House, Ltd. ("Bolt Supply") which affects the comparison of operating results between the third quarter of 2018 compared to 2017. Additionally, the Company adopted ASC 606 on a modified retrospective basis as of January 1, 2018. Accordingly, 2017 amounts are not restated.

Quarter ended September 30, 2018 compared to quarter ended September 30, 2017

(Dollars in thousands)	2018		2017		% of Net Sales
	Amount	% of Net Sales	Amount	% of Net Sales	
Revenue	\$88,530	100.0 %	\$75,651	100.0 %	
Cost of goods sold	40,422	45.7 %	29,646	39.2 %	
Gross profit	48,108	54.3 %	46,005	60.8 %	
Operating expenses:					
Selling expenses	22,175	25.0 %	24,354	32.2 %	
General and administrative expenses	28,199	31.9 %	20,561	27.2 %	
Total SG&A	50,374	56.9 %	44,915	59.4 %	
Operating income (loss)	(2,266)	(2.6)%	1,090	1.4 %	
Interest expense	(251)	(0.3)%	(133)	(0.2)%	
Other income, net	170	0.2 %	843	1.2 %	
Income (loss) before income taxes	(2,347)	(2.7)%	1,800	2.4 %	

Explanation of Responses:

Income tax expense (benefit)	(1,531)	(1.8)%	479	0.7	%
Net income (loss)	\$(816)	(0.9)%	\$1,321	1.7	%

16

Table of Contents

Revenue and Gross Profits

(Dollars in thousands)	Three Months Ended		Increase	
	September 30, 2018	2017	(Decrease) Amount	%
Revenue				
Lawson	\$78,692	\$75,651	\$3,041	4.0%
Bolt Supply	9,838	—	9,838	
Consolidated	\$88,530	\$75,651	\$12,879	17.0%
Gross profit				
Lawson	\$44,452	\$46,005	\$(1,553)	(3.4)%
Bolt Supply	3,656	—	3,656	
Consolidated	\$48,108	\$46,005	\$2,103	4.6%
Gross profit margin				
Lawson	56.5	% 60.8	%	
Bolt Supply	37.2	%		
Consolidated	54.3	% 60.8	%	

Total sales increased 17.0% to \$88.5 million in the third quarter of 2018 compared to \$75.7 million in the third quarter of 2017. There were 63 selling days in both periods. Average daily sales grew to \$1.405 million in the third quarter of 2018 compared to \$1.201 million in the prior year quarter. The Lawson segment total sales were positively impacted by a 6.6% improvement in sales productivity of sales representatives and a strong MRO marketplace. The third quarter of 2018 revenue was also positively impacted by \$9.8 million from the acquisition of Bolt Supply in the fourth quarter of 2017.

Gross Profit

Gross profit increased \$2.1 million to \$48.1 million in the third quarter of 2018 compared to \$46.0 million in the third quarter of 2017, primarily due to increased sales and the acquisition of The Bolt Supply House, partially offset by \$3.4 million due to the adoption of ASC 606. Consolidated gross profit as a percent of sales decreased to 54.3% from 60.8% a year ago primarily due to the selling expense reclassification related to the separately identified vendor managed inventory services performance obligation costs that had historically been classified as selling expenses and the inclusion of Bolt Supply. Prior to the reclassification, the Lawson segment gross profit increased to 60.9%, essentially flat with gross profit percent of 60.8% a year ago.

Selling, General and Administrative Expenses

(Dollars in thousands)	Three Months Ended		Increase	
	September 30, 2018	2017	(Decrease) Amount	%
Selling expenses				
Lawson	\$21,372	\$24,354	\$(2,982)	(12.2)%
Bolt Supply	803	—	803	
Consolidated	\$22,175	\$24,354	\$(2,179)	(8.9)%

Explanation of Responses:

General and administrative expenses

Lawson	\$26,035	\$20,561	\$5,474	26.6%
Bolt Supply	2,164	—	2,164	
Consolidated	\$28,199	\$20,561	\$7,638	37.1%

17

Table of Contents

Selling expenses consist of compensation and support for our sales representatives. Selling expenses decreased to \$22.2 million in the third quarter of 2018 from \$24.4 million in the prior year quarter and, as a percent of sales, decreased to 25.0% from 32.2% in the third quarter of 2017. The \$2.2 million decrease is primarily due to the \$3.5 million reclassification of services expense related to the separately identified vendor managed inventory services performance obligation to cost of revenues, partially offset by the inclusion of Bolt Supply in the quarter. As a percent of sales, selling expenses decreased to 25.0% from 32.2% due primarily to the reclassification of expenses to cost of sales and the proportionately lower selling expense structure in Bolt Supply's operations.

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses increased to \$28.2 million in the third quarter of 2018 from \$20.6 million in the prior year quarter. The increase was primarily driven by \$7.6 million of stock based compensation expense, a portion of which fluctuates with the Company stock price, and inclusion of Bolt Supply expenses.

Interest Expense and Other Income, Net

Interest expense increased \$0.1 million over the prior year quarter, due primarily to increased borrowings related to the Bolt Supply acquisition. Other income, net decreased \$0.7 million over the prior year quarter due primarily to the lower volatility in the Canadian currency exchange rate in the third quarter 2018 compared to the third quarter 2017.

Income Tax Expense

Income tax benefit of \$1.5 million, resulting in a 65.2% effective tax rate, was recorded for the three months ended September 30, 2018. Our effective tax rate is higher than the U.S. statutory rate due mainly to state taxes, income in higher tax jurisdictions, a Global Intangible Low Taxed Income Inclusion as a result of the 2017 Tax Cuts and Jobs Act, and other discrete items which primarily consisted of the finalization of foreign earnings and profit calculation. Excluding discrete items our effective tax rate was 25.7% for the three months ended September 30, 2018. In the fourth quarter of 2017, the Company eliminated substantially all of its U.S. reserves against its deferred tax assets as the Company was in a three year cumulative income position in the U.S. and we had reached a point of increased confidence in our ability to sustain profit levels. An income tax expense of \$0.5 million was recorded for the three months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

Nine months ended September 30, 2018 compared to September 30, 2017

(\$ in thousands)	2018		2017	
	Amount	% of Net Sales	Amount	% of Net Sales
Revenue	\$263,371	100.0 %	\$225,274	100.0 %
Cost of goods sold	119,914	45.5 %	89,249	39.6 %
Gross profit	143,457	54.5 %	136,025	60.4 %
Operating expenses:				
Selling expenses	66,119	25.1 %	72,964	32.4 %
General and administrative expenses	72,213	27.5 %	58,790	26.1 %
Total SG&A	138,332	52.6 %	131,754	58.5 %
Gain on sale of property	—	— %	(5,422)	(2.4)%
Operating expenses	138,332	52.6 %	126,332	56.1 %

Explanation of Responses:

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Operating income	5,125	1.9	%	9,693	4.3	%		
Interest expense	(755)	(0.3)%	(393)	(0.2)%
Other income (expense), net	(320)	(0.1)%	953		0.5	%
Income before income taxes	4,050	1.5	%	10,253	4.6	%		
Income tax expense	436	0.1	%	802	0.4	%		
Net income	\$3,614	1.4	%	\$9,451	4.2	%		

18

Table of Contents

Revenue and Gross Profit

(Dollars in thousands)	Nine Months Ended		Increase	
	September 30, 2018	September 30, 2017	(Decrease) Amount	%
Revenue				
Lawson	\$235,735	\$225,274	\$10,461	4.6%
Bolt Supply	27,636	—	27,636	
Consolidated	\$263,371	\$225,274	\$38,097	16.9%
Gross profit				
Lawson	\$132,671	\$136,025	\$(3,354)	(2.5)%
Bolt Supply	10,786	—	10,786	
Consolidated	\$143,457	\$136,025	\$7,432	5.5%
Gross profit margin				
Lawson	56.3	% 60.4		%
Bolt Supply	39.0	%		
Consolidated	54.5	% 60.4		%

Revenue

Revenue for the nine months ended September 30, 2018 increased 16.9% to \$263.4 million from \$225.3 million for the nine months ended September 30, 2017. Average daily sales improved 17.6% to \$1.386 million in the first nine months of 2018 compared to \$1.179 million in the prior year period. The first nine months of 2018 and 2017 had 190 and 191 selling days, respectively. Sales in the first nine months of 2018 were positively impacted by improved year to date sales rep productivity of 7.4%, the effect of the Bolt acquisition and a strong MRO marketplace, as shown by the increase in average PMI to 59.6 from 57.1 in the prior year to date.

Gross Profit

Gross profit increased to \$143.5 million in the first nine months of 2018 compared to \$136.0 million in the first nine months of 2017 and decreased as a percent of sales to 54.5% from 60.4% a year ago. The decline in the gross profit margin percentage from a year ago was primarily driven by a \$10.2 million selling expense reclassification related to the separately identified vendor managed inventory services performance obligation costs that had historically been classified as selling expenses, the inclusion of Bolt Supply and higher sales to large national customers who typically have lower product margins. Prior to the reclassification, the Lawson segment gross profit was 60.6%, essentially flat with 60.4% a year ago.

Selling, General and Administrative Expenses

(Dollars in thousands)	Nine Months		Increase	
	Ended September 30, 2018	Ended September 30, 2017	(Decrease) Amount	%
Selling expenses				
Lawson	\$63,870	\$72,964	\$(9,094)	(12.5)%

Explanation of Responses:

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Bolt Supply	2,249	—	2,249	
Consolidated	\$66,119	\$72,964	\$(6,845)	(9.4)%

General and administrative expenses

Lawson	\$65,739	\$58,790	\$6,949	11.8%
Bolt Supply	6,474	—	6,474	
Consolidated	\$72,213	\$58,790	\$13,423	22.8%

19

Table of Contents

Selling Expenses

Selling expenses decreased to \$66.1 million for the first nine months of 2018 from \$73.0 million in the first nine months of 2017. The decrease is primarily due to the \$10.2 million reclassification of services expense related to the separately identified vendor managed inventory services obligation to cost of revenues, partially offset by the inclusion of Bolt Supply and increased compensation costs on higher sales.

General and Administrative Expenses

General and administrative expenses increased to \$72.2 million in the first nine months of 2017 from \$58.8 million in the prior year period primarily driven by increased stock-based compensation expense of \$6.0 million, a portion of which varies with the company stock price, and the inclusion of Bolt Supply expenses of \$6.5 million.

Gain on sale of property

In the second quarter of 2017, we received net cash proceeds of \$6.2 million and recognized a gain of \$5.4 million from the sale of our Fairfield, New Jersey distribution center.

Interest Expense

Interest expenses increased \$0.4 million in the first nine months of 2018, over the prior year, due primarily to higher average borrowings outstanding.

Other (expense) Income, Net

Other (expense) income, net decreased \$1.3 million in the first nine months of 2018, primarily due to the effect of changes in the Canadian currency exchange rate.

Income Tax Expense

Income tax expenses were \$0.4 million resulting in a 10.8% effective tax rate for the nine months ended September 30, 2018. Our effective tax rate is lower than the U.S. statutory rate due to discrete items such as the finalization of our calculation for previously untaxed foreign earnings and profits. Excluding discrete items, the Company's effective tax rate was 33.5% for the nine months ended September 30, 2018. In the fourth quarter of 2017, the Company eliminated substantially all of its U.S. reserves against its deferred tax assets as the Company was in a three year cumulative income position in the U.S. and we had reached a point of increased confidence in our ability to sustain profit levels. Income tax expense of \$0.8 million was recorded for the nine months ended September 30, 2017 as substantially all deferred tax assets were still subject to a tax valuation allowance at that time.

Table of Contents

Liquidity and Capital Resources

Available cash and cash equivalents were \$7.7 million on September 30, 2018 compared to \$4.4 million on December 31, 2017. Net cash provided by operations for the nine months ended September 30, 2018 and 2017 was \$10.2 million and \$3.8 million, respectively, as cash generated by operating earnings was partially offset by cash invested in working capital, primarily to support the increase in sales.

Capital expenditures, primarily for improvements to our distribution centers and information technology, were \$1.6 million and \$1.2 million for the nine month periods ended September 30, 2018 and 2017, respectively. In the second quarter of 2017, we completed the sale of our distribution center located in Fairfield, New Jersey, receiving net cash proceeds of \$6.2 million.

The Company used \$4.6 million in financing activities primarily resulting from net payments on its revolving lines of credit.

Subsequent to the reporting period ended September 30, 2018, we completed the acquisition of Screw Products, Inc. with a cash payment of \$5.2 million.

We believe cash provided by operations and funds available under our Loan Agreements are sufficient to fund our operating requirements, strategic initiatives and capital improvements for the next 12 months.

Lawson Loan Agreement

On September 30, 2018, we had \$8.4 million of borrowings under our Lawson revolving line of credit facility and we had additional borrowing availability of \$27.0 million. Dividends are currently restricted under the Lawson Loan Agreement to amounts not to exceed \$7.0 million annually and no dividends were paid to shareholders in the nine months ended September 30, 2018 and 2017.

In addition to other customary representations, warranties and covenants, if the excess borrowing capacity under our revolving line of credit facility is below \$10.0 million, we are required to meet a minimum trailing twelve month EBITDA to fixed charges ratio, as defined in the amended Loan Agreement. On September 30, 2018, our borrowing capacity exceeded \$10.0 million, therefore, we were not subject to this financial covenant. However, for informational purposes we have provided the result of the financial covenant below:

Quarterly Financial Covenant	Requirement	Actual
EBITDA to fixed charges ratio	1.10 : 1.00	3.60 : 1.00

While we were in compliance with the financial covenant for the quarter ended September 30, 2018, failure to meet this covenant requirement in future quarters could lead to higher financing costs, increased restrictions, or reduce or eliminate our ability to borrow funds and could have a material adverse effect on our business, financial condition and results of operations.

Bolt Commitment Letter

At September 30, 2018, Bolt had \$2.0 million Canadian dollars of outstanding borrowings and remaining borrowing availability of \$3.5 million Canadian dollars under a Commitment Letter. The Commitment Letter is subject to a working capital ratio of 1.35:1, a maximum ratio of debt to tangible net worth of 2.5:1 of the Bolt assets and Debt Service Coverage Ratio 1.25:1 as defined in the Commitment Letter. At September 30, 2018, Bolt was in compliance with all covenants which are subject to periodic review, at least annually, with the next review due by August 31, 2019.

Explanation of Responses:

Table of Contents

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk at September 30, 2018 from that reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

ITEM 4. CONTROLS AND PROCEDURES

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

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II
OTHER INFORMATION

ITEMS 1, 1A, 2, 3, 4 and 5 of Part II are inapplicable and have been omitted from this report.

ITEM 6. EXHIBITS

Exhibit #

- 31.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32 Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

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: October 25, 2018 /s/ Michael G. DeCata
Michael G. DeCata
President and Chief Executive Officer
(principal executive officer)

Dated: October 25, 2018 /s/ Ronald J. Knutson
Ronald J. Knutson
Executive Vice President, Chief Financial Officer, Treasurer and Controller
(principal financial and accounting officer)

23