COLGATE PALMOLIVE CO
Form 10-Q
April 30, 2015

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from________ to________ .

Commission File Number: 1-644

COLGATE-PALMOLIVE COMPANY
(Exact name of registrant as specified in its charter)

DELAWARE	13-1815595
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
300 Park Avenue, New York, New York	10022
(Address of principal executive offices)	(Zip Code)

(212) 310-2000
(Registrant's telephone number, including area code)
NO CHANGES
(Former name, former address and former fiscal year, if changed since last report)

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x	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 in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Shares Outstanding	Date
Common stock, $1.00 par value	904,569,917	March 31, 2015

PART I. FINANCIAL INFORMATION

COLGATE-PALMOLIVE COMPANY
Condensed Consolidated Statements of Income
(Dollars in Millions Except Per Share Amounts)
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net sales	$4,070	$4,325
Cost of sales	1,678	1,801
Gross profit	2,392	2,524
Selling, general and administrative expenses	1,450	1,544
Other (income) expense, net	82	346
Operating profit	860	634
Interest (income) expense, net	8	7
Income before income taxes	852	627
Provision for income taxes	269	195
Net income including noncontrolling interests	583	432
Less: Net income attributable to noncontrolling interests	41	44
Net income attributable to Colgate-Palmolive Company	$542	$388
Earnings per common share, basic	$0.60	$0.42
Earnings per common share, diluted	$0.59	$0.42
Dividends declared per common share *	$0.74	$0.70

* Two dividends were declared in each period.

See Notes to Condensed Consolidated Financial Statements.

COLGATE-PALMOLIVE COMPANY
Condensed Consolidated Statements of Comprehensive Income
(Dollars in Millions)
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net income including noncontrolling interests	$583	$432
Other comprehensive income (loss), net of tax:		
Cumulative translation adjustments	(351)	(44)
Retirement plans and other retiree benefit adjustments	13	13
Gains (losses) on available-for-sale securities	(1)	(56)
Gains (losses) on cash flow hedges	—	—
Total Other comprehensive income (loss), net of tax	(339)	(87)
Total Comprehensive income including noncontrolling interests	244	345
Less: Net income attributable to noncontrolling interests	41	44
Less: Cumulative translation adjustments attributable to noncontrolling interests	1	(1)
Total Comprehensive income attributable to noncontrolling interests	42	43
Total Comprehensive income attributable to Colgate-Palmolive Company	$202	$302

See Notes to Condensed Consolidated Financial Statements.

COLGATE-PALMOLIVE COMPANY
Condensed Consolidated Balance Sheets
(Dollars in Millions)
(Unaudited)

	March 31, 2015	December 31, 2014
Assets		
Current Assets		
Cash and cash equivalents	$859	$1,089
Receivables (net of allowances of $58 and $54, respectively)	1,611	1,552
Inventories	1,350	1,382
Other current assets	880	840
Total current assets	4,700	4,863
Property, plant and equipment:		
Cost	8,212	8,385
Less: Accumulated depreciation	(4,244)	(4,305)
	3,968	4,080
Goodwill	2,186	2,307
Other intangible assets, net	1,356	1,413
Deferred income taxes	79	76
Other assets	867	720
Total assets	$13,156	$13,459
Liabilities and Shareholders’ Equity		
Current Liabilities		
Notes and loans payable	$18	$16
Current portion of long-term debt	488	488
Accounts payable	1,167	1,231
Accrued income taxes	417	294
Other accruals	2,233	1,917
Total current liabilities	4,323	3,946
Long-term debt	5,622	5,644
Deferred income taxes	233	261
Other liabilities	2,239	2,223
Total liabilities	12,417	12,074
Shareholders’ Equity		
Common stock	1,466	1,466
Additional paid-in capital	1,272	1,236
Retained earnings	18,704	18,832
Accumulated other comprehensive income (loss)	(3,847)	(3,507)
Unearned compensation	(13)	(20)
Treasury stock, at cost	(17,122)	(16,862)
Total Colgate-Palmolive Company shareholders’ equity	460	1,145
Noncontrolling interests	279	240
Total shareholders’ equity	739	1,385
Total liabilities and shareholders’ equity	$13,156	$13,459

See Notes to Condensed Consolidated Financial Statements.

COLGATE-PALMOLIVE COMPANY
Condensed Consolidated Statements of Cash Flows
(Dollars in Millions)
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Operating Activities		
Net income including noncontrolling interests	$583	$432
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operations:		
Depreciation and amortization	114	108
Restructuring and termination benefits, net of cash	57	45
Venezuela remeasurement charges	—	266
Stock-based compensation expense	32	34
Deferred income taxes	(22)	(21)
Cash effects of changes in:		
Receivables	(150)	(77)
Inventories	(23)	(67)
Accounts payable and other accruals	111	100
Other non-current assets and liabilities	25	—
Net cash provided by operations	727	820
Investing Activities		
Capital expenditures	(122)	(168)
Purchases of marketable securities and investments	(252)	(151)
Proceeds from sale of marketable securities and investments	110	74
Payment for acquisitions, net of cash acquired	—	(25)
Other	7	21
Net cash used in investing activities	(257)	(249)
Financing Activities		
Principal payments on debt	(2,171)	(1,938)
Proceeds from issuance of debt	2,105	2,960
Dividends paid	(329)	(316)
Purchases of treasury shares	(374)	(453)
Proceeds from exercise of stock options and excess tax benefits	128	50
Net cash (used in) provided by financing activities	(641)	303
Effect of exchange rate changes on Cash and cash equivalents	(59)	(41)
Net (decrease) increase in Cash and cash equivalents	(230)	833
Cash and cash equivalents at beginning of the period	1,089	962
Cash and cash equivalents at end of the period	$859	$1,795
Supplemental Cash Flow Information		
Income taxes paid	$164	$171

See Notes to Condensed Consolidated Financial Statements.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

1. Basis of Presentation

The Condensed Consolidated Financial Statements reflect all normal recurring adjustments which, in management's opinion, are necessary for a fair statement of the results for interim periods. Results of operations for interim periods may not be representative of results to be expected for a full year. Certain prior year amounts have been reclassified to conform to the current year presentation.

For a complete set of financial statement notes, including the significant accounting policies of Colgate-Palmolive Company (together with its subsidiaries, the "Company" or "Colgate"), refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission.

2. Use of Estimates

Provisions for certain expenses, including income taxes, media advertising and consumer promotion, are based on full year assumptions and are included in the accompanying Condensed Consolidated Financial Statements in proportion with estimated annual tax rates, the passage of time or estimated annual sales.

3. Recent Accounting Pronouncements

On April 7, 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03 "Simplifying the Presentation of Debt Issuance Costs," which requires that debt issuance costs be presented in the balance sheet as a direct deduction from the carrying amount of related debt liability, consistent with debt discounts. Under current accounting standards, such costs are recorded as an asset. The new guidance is effective for the Company beginning January 1, 2016, with early adoption permitted. This new guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

On February 18, 2015, the FASB issued ASU No. 2015-02 "Consolidation (Topic 810): Amendments to the Consolidation Analysis" that amends the current consolidation guidance. The amendments affect both the variable interest entity and voting interest entity consolidation models. The new guidance is effective for the Company beginning January 1, 2016, with early adoption permitted. This new guidance is not expected to have a material impact on the Company's Consolidated Financial Statements.

On May 28, 2014, the FASB and the International Accounting Standards Board ("IASB") issued their final converged standard on revenue recognition. The standard, issued as ASU No. 2014-09 "Revenue from Contracts with Customers" by the FASB, provides a single, comprehensive revenue recognition model for all contracts with customers and supersedes current revenue recognition guidance. The revenue standard contains principles that an entity will apply to determine the measurement of revenue and timing of when it is recognized. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The new standard also includes enhanced disclosures which are significantly more comprehensive than those in existing revenue standards. This new guidance is currently effective for the Company beginning January 1, 2017, with no early adoption permitted. The standard allows for either "full retrospective" adoption, meaning the standard is applied to all of the periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. While the Company is currently assessing the impact of the new standard, it does not expect this new guidance to have a material impact on its Consolidated Financial Statements.

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COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

4. Acquisitions and Divestitures

Acquisition

On October 3, 2014, the Company acquired an oral care business in Myanmar for $62 in cash plus additional consideration contingent upon achievement of performance targets under a distribution services agreement.

Sale of Land in Mexico

On September 13, 2011, the Company's Mexican subsidiary entered into an agreement to sell to the United States of America (the "Purchaser") the Mexico City site on which its commercial operations, technology center and soap production facility were located. The sale price is payable in three installments. During the third quarter of 2011, the Company received the first installment of $24 upon signing the agreement. During the third quarter of 2012, the Company received the second installment of $36. The parties subsequently amended that agreement to extend the closing date and are in the process of negotiating an additional amendment. Under the existing agreement, the final installment of the purchase price is due upon the transfer of the property, which is subject to the Company's satisfaction of certain closing conditions relating to site preparation by May 19, 2015. While these conditions are not expected to be fully satisfied by May 19, 2015, in which case the Purchaser has several options under the agreement (including termination and the return to it of the first two installments of the purchase price), based on the discussions to date, the Company believes that the transfer of the property is still likely to occur in 2015. The Company has reinvested the first two installments to relocate its soap production to a new state-of-the-art facility at its Mission Hills, Mexico site, to relocate its commercial and technology operations within Mexico City and to prepare the existing site for transfer. Exit costs incurred during the project primarily relate to staff leaving indemnities, accelerated depreciation and demolition to make the site building-ready. During the three months ended March 31, 2015 and 2014, the Company recorded $0 and $1 of pretax costs ($0 and $1 of aftertax costs), respectively, related to the sale.

5. Restructuring and Related Implementation Charges

In the fourth quarter of 2012, the Company commenced a four-year Global Growth and Efficiency Program for sustained growth. The program's initiatives are expected to help Colgate ensure continued solid worldwide growth in unit volume, organic sales and earnings per share and enhance its global leadership positions in its core businesses.

On October 23, 2014, the Company's Board of Directors approved an expansion of the Global Growth and Efficiency Program (as expanded, the "2012 Restructuring Program") to take advantage of additional savings opportunities.

Cumulative pretax charges related to the 2012 Restructuring Program, once all phases are approved and implemented, are estimated to be $1,285 to $1,435 ($950 to $1,050 aftertax). Implementation of the 2012 Restructuring Program is expected to be substantially completed by December 31, 2016. These pretax charges are currently estimated to be comprised of the following categories: Employee-Related Costs, including severance, pension and other termination benefits (50%); asset-related costs, primarily Incremental Depreciation and Asset Impairments (10%); and Other charges, which include contract termination costs, consisting primarily of implementation-related charges resulting directly from exit activities (20%) and the implementation of new strategies (20%). Anticipated pretax charges for 2015 are expected to amount to approximately $330 to $385 ($245 to $285 aftertax). Over the course of the 2012 Restructuring Program, it is currently estimated that approximately 75% of the charges will result in cash expenditures.

It is expected that the cumulative pretax charges, once all projects are approved and implemented, will relate to initiatives undertaken in North America (15%), Europe/South Pacific (20%), Latin America (5%), Asia (5%), Africa/Eurasia (5%), Hill's Pet Nutrition (10%) and Corporate (40%), which includes substantially all of the costs related to the implementation of new strategies, noted above, on a global basis. It is expected that, by the end of 2016, the 2012 Restructuring Program will contribute a net reduction of approximately 2,000-2,500 positions from the Company's global employee workforce.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

For the three months ended March 31, 2015 and 2014, restructuring and implementation-related charges are reflected in the Condensed Consolidated Statements of Income as follows:

	Three Months Ended March 31,	
	2015	2014
Cost of sales	$4	$10
Selling, general and administrative expenses	18	17
Other (income) expense, net	78	75
Total 2012 Restructuring Program charges, pretax	$100	$102
Total 2012 Restructuring Program charges, aftertax	$67	$73

Restructuring and related implementation charges in the preceding table are recorded in the Corporate segment as these initiatives are predominantly centrally directed and controlled and are not included in internal measures of segment operating performance.

Total charges incurred for the 2012 Restructuring Program relate to initiatives undertaken by the following reportable operating segments:

	Three Months Ended March 31,				Program-to-date Accumulated Charges	
	2015		2014			
North America	18	%	9	%	11	%
Latin America	—	%	4	%	3	%
Europe/South Pacific	7	%	21	%	25	%
Asia	—	%	—	%	1	%
Africa/Eurasia	3	%	2	%	5	%
Hill’s Pet Nutrition	4	%	8	%	8	%
Corporate	68	%	56	%	47	%

Since the inception of the 2012 Restructuring Program in the fourth quarter of 2012, the Company has incurred pretax cumulative charges of $846 ($623 aftertax) in connection with the implementation of various projects as follows:

	Cumulative Charges as of March 31, 2015
Employee-Related Costs	$330
Incremental Depreciation	57
Asset Impairments	2
Other	457
Total	$846

The majority of costs incurred since inception relate to the following projects: the implementation of the Company’s overall hubbing strategy; the consolidation of facilities; the simplification and streamlining of the Company’s research and development capabilities and oral care supply chain, both in Europe; the extension of shared business services and streamlining of global functions; restructuring how the Company will provide future retirement benefits to substantially all of its U.S.-based employees participating in the Company’s defined benefit retirement plan by shifting them to the Company’s defined contribution plan; and the closing of the Morristown, New Jersey personal care facility.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

The following table summarizes the activity for the restructuring and implementation-related charges discussed above and the related accruals:

	Three Months Ended March 31, 2015				
	Employee-Related Costs	Incremental Depreciation	Asset Impairments	Other	Total
Balance at December 31, 2014	$85	$—	$—	$107	$192
Charges	35	6	—	59	100
Cash payments	(15)	—	—	(26)	(41)
Charges against assets	(8)	(6)	—	—	(14)
Foreign exchange	(5)	—	—	(1)	(6)
Balance at March 31, 2015	$92	$—	$—	$139	$231

Employee-Related Costs primarily include severance and other termination benefits and are calculated based on long-standing benefit practices, local statutory requirements and, in certain cases, voluntary termination arrangements. Employee-Related Costs also include pension and other retiree benefit enhancements amounting to $8 for the three months ended March 31, 2015, which are reflected as Charges against assets within Employee-Related Costs in the preceding tables, as the corresponding balance sheet amounts are reflected as a reduction of pension assets or an increase in pension and other retiree benefit liabilities (see Note 10, Retirement Plans and Other Retiree Benefits).

Incremental Depreciation is recorded to reflect changes in useful lives and estimated residual values for long-lived assets that will be taken out of service prior to the end of their normal service period. Asset Impairments are recorded to write down assets held for sale or disposal to their fair value based on amounts expected to be realized. Charges against assets within Asset Impairments are net of cash proceeds pertaining to the sale of certain assets.

Other charges consist primarily of charges resulting directly from exit activities and the implementation of new strategies as a result of the 2012 Restructuring Program. These charges for the three months ended March 31, 2015 include third-party incremental costs related to the development and implementation of new business and strategic initiatives of $12 and contract termination costs and charges resulting directly from exit activities of $3 directly related to the 2012 Restructuring Program. These charges were expensed as incurred. Also included in Other charges for the three months ended March 31, 2015 are other exit costs of $44 related to the consolidation of facilities.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

6. Inventories

Inventories by major class are as follows:

	March 31, 2015	December 31, 2014
Raw materials and supplies	$323	$349
Work-in-process	56	55
Finished goods	971	978
Total Inventories	$1,350	$1,382

7. Shareholders' Equity

Changes in the components of Shareholders' Equity for the three months ended March 31, 2015 are as follows:

	Colgate-Palmolive Company Shareholders' Equity						Noncontrolling Interests
	Common Stock	Additional Paid-in Capital	Unearned Compensation	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	
Balance, December 31, 2014	$1,466	$1,236	$(20)	$(16,862)	$18,832	$(3,507)	$240
Net income					542		41
Other comprehensive income (loss), net of tax						(340)	1
Dividends					(670)		(3)
Stock-based compensation expense		32					
Shares issued for stock options		32		85			
Shares issued for restricted stock awards		(29)		29			
Treasury stock acquired				(374)			
Other		1	7				
Balance, March 31, 2015	$1,466	$1,272	$(13)	$(17,122)	$18,704	$(3,847)	$279

Accumulated other comprehensive income (loss) includes cumulative translation losses of $2,805 and $2,453 at March 31, 2015 and December 31, 2014, respectively, and unrecognized retirement plan and other retiree benefits costs of $1,051 and $1,064 at March 31, 2015 and December 31, 2014, respectively.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

8. Earnings Per Share

	Three Months Ended					
	March 31, 2015			March 31, 2014		
	Net income attributable to Colgate-Palmolive Company	Shares (millions)	Per Share	Net income attributable to Colgate-Palmolive Company	Shares (millions)	Per Share
Basic EPS	$542	907.7	$0.60	$388	919.5	$0.42
Stock options and restricted stock units		8.6			9.1	
Diluted EPS	$542	916.3	$0.59	$388	928.6	$0.42

For the three months ended March 31, 2015 and 2014, the average number of stock options and restricted stock units that were anti-dilutive and not included in diluted earnings per share calculations were 1,566,993 and 3,374,995, respectively.

Basic and diluted earnings per share are computed independently for each quarter and any year-to-date period presented. As a result of changes in shares outstanding during the year and rounding, the sum of the quarters' earnings per share may not necessarily equal the earnings per share for any year-to-date period.

COLGATE-PALMOLIVE COMPANY
Notes to Condensed Consolidated Financial Statements (continued)
(Dollars in Millions Except Share and Per Share Amounts)
(Unaudited)

9. Other Comprehensive Income (Loss)

Additions to and reclassifications out of Accumulated other comprehensive income (loss) attributable to the Company for the three months ended March 31, 2015 and 2014 were as follows:

	2015		2014	
	Pretax	Net of Tax	Pretax	Net of Tax
Cumulative translation adjustments	$(340)	$(352)	$ (39)	$ (43)
Retirement plans and other retiree benefits:				
Net actuarial gain (loss) and prior service costs arising during the period	(1)	(1)	3	2
Amortization of net actuarial loss, transition and prior service costs [(1)]	22	14	One of the Company's subsidiaries, Drummond American LLC (“Drummond”), is under an employment tax examination for the years 2007 and 2008 of the long-standing treatment of its sales representatives as independent contractors. In January 2012 the Company received a Notice of Proposed Adjustment in the amount of $9.5 million, including penalties, from the IRS challenging Drummond's position that the sales representatives	

were independent contractors. The Company disagreed with the IRS position and filed an administrative appeal with the IRS Appeals Office.

Although the Company intends to vigorously defend its position for the treatment of its sales representatives as independent contractors, the Company established a liability of $1.2 million during 2011 as its best estimate of the cost to resolve the matter with the IRS. The Company has maintained this liability throughout 2012 and 2013. The notice of Proposed Adjustment was determined by applying the full statutory rates and penalties, rather than applying the reduced tax rates provided by section 3509

of the Internal Revenue Code. The Company believes the use of reduced tax rates is mandatory for all IRS worker classification assessments, except when the employer intentionally disregarded its employment tax obligations. Because the Company believes it fully complied with its employment tax obligations, the Company based its estimated liability at the reduced tax rates. The Company applied these reduced tax rates against only one year because any settlement resolution would likely be limited to one year as this is consistent with the IRS's settlement practices. The Company has assessed its potential exposure for other subsidiaries and time periods and has

concluded that an additional liability is not probable. No adjustment has been proposed by the IRS for any other time periods or subsidiaries of the Company.

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The case has been assigned to the Chicago Appeals Office. The Company is unable to establish an estimated time frame in which the case will be resolved through the appeals process. An unfavorable outcome of this matter could have a material adverse effect on the Company’s business, financial condition and results of operations.

Environmental matters
In 2012, the Company identified that a site owned by its ASMP subsidiary in Alabama contained hazardous substances in the soil and groundwater as a result of historical operations prior to the Company's ownership.

This site is not part of the sale under the Asset Purchase Agreement described in Note 2 - Discontinued Operations. The Company has retained an environmental consulting firm to further investigate the contamination, including the measurement and monitoring of the site. At this time insufficient data regarding the situation have been collected to reasonably estimate the cost, if any, of remediating this situation. Accordingly, the Company has not established a reserve for any remediation costs.

Note 10 — Gain on sale of assets

During the nine months ended September 30, 2012, in conjunction with the construction of the new

distribution center in McCook, Illinois and the relocation of the Company's headquarters to Chicago, Illinois, the Company sold three properties; its Addison, Illinois distribution center, its Vernon Hills, Illinois distribution center and a Des Plaines, Illinois administrative building. The Company received cash proceeds of $8.8 million for the sale of the three facilities, resulting in a gain of $2.1 million.

Note 11 — Goodwill Impairment

During the second quarter of 2012, the Company evaluated goodwill for potential impairment by determining if certain qualitative events had occurred or if

circumstances had changed that would more likely than not reduce the fair value of a reporting unit below its carrying value. As a result of this evaluation, the Company identified indicators of impairment related to operating losses and reduced market capitalization and, therefore, performed an interim impairment test of goodwill.

The Company estimated the fair value of the MRO reporting unit using a discounted cash flow analysis based on its current internal operating forecast to determine the reporting unit's fair value. After completing the analysis, the Company concluded that the entire amount of the goodwill was impaired and a non-cash charge of $28.3

million was recorded in the second quarter of 2012.

Goodwill activity for the three and nine months ended September 30, 2013 and 2012 was as follows:

	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012
Beginning balance	$ —	$ —	$ —	$ 28,148
Impairment loss	—	—	—	(28,306)
Translation adjustment	—	—	—	158
Ending balance	$ —	$ —	$ —	$ —

Note 12 — Non-Cash Items

During the nine months ended September 30, 2012, the Company recorded an $8.0 million increase in property, plant and equipment, along with a corresponding increase in liabilities, related to the financing lease obligation associated with the McCook, Illinois

distribution center. These non-cash increases have been excluded from the Condensed Consolidated Statements of Cash Flows.

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

Overview

Following the discontinuance of our Original Equipment Manufacturers ("OEM") segment (See Note 2 - Discontinued Operations), we now operate in one reportable segment: the Maintenance, Repair and Operations ("MRO") segment as a distributor of products and services to the industrial, commercial, institutional, and governmental maintenance, repair and operations marketplace. Certain reclassifications have been

made to prior period amounts to conform to current period presentation. Such reclassifications have no effect on net income as previously reported.

The MRO industry is highly fragmented. We compete for business with several national distributors as well as a large number of regional and local distributors. The MRO business is significantly influenced by the overall strength of the manufacturing sector of the U.S. economy. One measure used to evaluate the strength of the industrial products market is the Purchasing Managers Index ("PMI") published by the Institute for Supply Management. A measure above 50%

generally indicates expansion of the manufacturing sector while a measure below 50% represents contraction. The average monthly PMI was 55.8 in the third quarter of 2013 compared to 50.9 in the third quarter of 2012 indicating an increase in the U.S. manufacturing growth rate from a year ago.

Our sales are also affected by the number of sales representatives and the amount of sales which each representative can generate, which we measure as average sales per day per sales representative. In 2013, we have focused on increasing the number of sales representatives, adding 11 net new sales representatives in the third quarter of 2013

to a total of 784 at September 30, 2013. We have a goal of increasing this total to over 800 active sales representatives by the end of 2013 and plan to continue to aggressively expand our sales force in 2014. While we anticipate future sales growth from our expanded sales force, we also anticipate a short-term decrease in average sales per day per sales representative, as new representatives build up customer relationships in their territories.

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Quarter ended September 30, 2013 compared to quarter ended September 30, 2012

A summary of our financial performance for the three months ended September 30, 2013 and 2012 is presented below:

	2013		2012	
($ in thousands)	Amount	% of Net Sales	Amount	% o Net Sale
Net sales	$68,235	100.0 %	$67,863	100.
Cost of goods sold	27,015	39.6 %	25,368	37.4
Gross profit	41,220	60.4 %	42,495	62.6
Operating expenses:				
Selling, general and administrative expenses:				
Selling expenses	21,305	31.2 %	20,317	29.9
General and administrative expenses	18,119	26.6 %	22,519	33.2
Total SG&A	39,424	57.8 %	42,836	63.1
Severance expense	962	1.4 %	1,410	2.1
Gain on sale of assets	(36)	(0.1)%	(11)	—
Total operating expenses	40,350	59.1 %	44,235	65.2
	870	1.3 %	(1,740)	(2.6

Operating income (loss)				
Other expenses, net	(384)	(0.6)%	(206)	(0.3
Income (loss) from continuing operations before income taxes	486	0.7 %	(1,946)	(2.9
Income tax expense (benefit)	303	0.4 %	(389)	(0.6
Income (loss) from continuing operations	$183	0.3 %	$(1,557)	(2.3

Net Sales

Net sales for the third quarter of 2013 increased to $68.2 million from $67.9 million in the third quarter of 2012 which included one less selling day. Excluding the Canadian exchange rate impact, net sales increased 1.0% for the quarter. Average daily sales decreased slightly to $1.066 million in the third quarter of 2013 compared to $1.077 million in the prior

year quarter. The decrease was primarily due to a decline of $1.6 million in governmental sales and a 1.2% decline in average daily sales per sales representative, as newly hired sales representatives are in the early stages of building up customer relationships in their territories.

Gross Profit

Gross profit decreased 3.0% in the third quarter of 2013, to $41.2 million from $42.5 million in the prior year period and decreased as a percent of net sales to 60.4% from 62.6% a year ago. The year ago quarter benefited from the sell through of previously discontinued products. We anticipate that our gross margin percentage may be under pressure in the

future as we continue to increase the penetration of national accounts in our customer mix and on-going competitive pressures.

Selling, General and Administrative Expenses

Selling Expenses

Selling expenses consist of commissions paid to our sales representatives and related expenses to support our sales efforts. Selling expenses increased $1.0 million to $21.3 million in the third quarter of 2013 from $20.3 million in the prior year quarter. As a percent of net sales, selling expenses increased to 31.2% in the third quarter of 2013 compared to 29.9% in the third quarter of 2012, primarily

due to hiring new sales representatives and increased health insurance costs of $0.7 million.

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General and Administrative Expenses

General and administrative expenses consist of expenses to operate our distribution network and overhead expenses to manage the business. General and administrative expenses decreased $4.4 million to $18.1 million in the third quarter of 2013 from $22.5 million in the prior year quarter as we continue to focus on cost control measures. The decrease was primarily driven by a reduction of $3.1 million in employee compensation, including employee incentives, and a decrease of $1.6 million in consulting expenses, partially offset

by a $0.6 million increase in temporary labor, primarily to support the transition of operations to the McCook distribution center.

Severance Expense

A $1.0 million severance expense was recorded in the third quarter of 2013, primarily related to various organizational restructurings. The $1.4 million severance expense recorded in the third quarter of 2012 primarily related to the retirement of our former President and Chief Executive Officer.

Other Expenses, Net

Other expenses, net of $0.4 million and $0.2 million for the three months ended September 30,

2013 and 2012, respectively, consist primarily of interest charged on the outstanding borrowings under our Loan Agreement.

Income Tax Expense (Benefit)

Primarily due to historical cumulative losses, substantially all of our deferred tax assets are subject to a tax valuation allowance. Although we are in a full tax valuation allowance position, a $0.3 million income tax expense and a $0.4 million income tax benefit were recorded for the three months ended September 30, 2013 and 2012, respectively, primarily due to the allocation of income tax between continuing and discontinued operations.

Income (Loss) from Continuing Operations

We reported income from continuing operations of $0.2 million in the third quarter of 2013 compared to a loss from continuing operations of $1.6 million in the third quarter of 2012.

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Nine months ended September 30, 2013 compared to the nine months ended September 30, 2012

A summary of our financial performance for the nine months ended September 30, 2013 and 2012 is presented below:

($ in thousands)	2013 Amount	% of Net Sales		2012 Amount	% N S
Net sales	$203,765	100.0	%	$209,057	1
Cost of goods sold	82,097	40.3	%	90,539	4
Gross profit	121,668	59.7	%	118,518	5
Operating expenses:					
Selling, general and administrative expenses:					
Selling expenses	63,530	31.2	%	62,189	2
General and administrative expenses	60,071	29.5	%	69,266	3
Total SG&A	123,601	60.7	%	131,455	6
Severance expense	964	0.4	%	8,180	3.
Gain on sale of assets	(36)	—	%	(2,133)	(1
Goodwill impairment	—	—	%	28,306	1
Total operating	124,529	61.1	%	165,808	7

expenses							
Operating loss	(2,861	)	(1.4	)%	(47,290	)	(2
Other expenses, net	(949	)	(0.5	)%	(526	)	(0
Loss from continuing operations before income taxes	(3,810	)	(1.9	)%	(47,816	)	(2
Income tax expense (benefit)	(398	)	(0.2	)%	17,453		8.
Loss from continuing operations	$(3,412	)	(1.7	)%	$(65,269	)	(3

Net Sales

Net sales for the nine months ended September 30, 2013 decreased 2.5% to $203.8 million from $209.1 million in the nine months ended September 30, 2012. Excluding the Canadian exchange rate impact, net sales decreased 2.3% compared to the same period last year. The $5.3 million decrease in sales was primarily due to a decrease in sales coverage in certain areas

due to a 6% decrease in the average number of sales representatives compared to a year ago, primarily in the first half of the year and lower government sales of $4.1 million compared to the same period last year. This decrease was partially offset by a 3% increase in average daily sales per sales representative over the prior year period. Average daily sales decreased 2.6% to $1.067 million in the nine months ended September 30, 2013 compared to $1.095 million in the first nine months of 2012.

Gross Profit

Gross profit increased 2.7% in the first nine months of 2013 to $121.7 million from $118.5 million in the prior year period and

increased as a percent of net sales to 59.7% from 56.7% a year ago. The improved gross margin was primarily driven by lower outbound freight costs and lower reserves for excess and obsolete inventory, as 2012 included a one-time $3.9 million charge specifically related to discontinuing certain products. We anticipate that our gross margin percentage may be under pressure in the future as we continue to increase the penetration of national accounts in our customer mix and on-going competitive pressures.

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Selling, General and Administrative Expenses

Selling Expenses

Selling expenses increased $1.3 million to $63.5 million in the first nine months of 2013 from $62.2 million in the prior year period. Selling expenses as a percent of net sales increased to 31.2% in the nine months ended September 30, 2013 compared to 29.8% in the first nine months of 2012, primarily due to increased health insurance costs of $2.2 million and $1.2 million of expenses related to our first quarter 2013 national sales meeting, partially offset by variable cost savings due to decreased sales.

General and Administrative Expenses

General and administrative expenses decreased $9.2 million to $60.1 million in the first nine months of 2013 from $69.3 million in the prior year period. The decrease was driven by actions taken in the first half of 2012 to reduce costs, primarily by a reduction in employee headcount and outside services, partially offset by a $2.4 million increase in stock based compensation.

Severance Expense

A $1.0 million severance expense was recorded in the nine months ended September 30, 2013, primarily related to various organizational restructurings. The severance

expense recorded in the nine months ended September 30, 2012 of $8.2 million related to the elimination of corporate and distribution positions, as a result of a strategic restructuring plan, and the retirement of our former President and Chief Executive Officer.

Gain on Sale of Assets

During the nine months ended September 30, 2012, in conjunction with the construction of a new distribution center in McCook, Illinois and the relocation of our headquarters to Chicago, Illinois, we sold three properties: our Addison, Illinois distribution center, our Vernon Hills, Illinois

distribution center and a Des Plaines, Illinois administrative building. We received cash proceeds of $8.8 million for the sale of the three facilities which resulted in a gain of $2.1 million.

Goodwill Impairment

During the second quarter of 2012, we assessed the fair value of the $28.3 million goodwill balance. Based on this assessment, we determined that the full amount of the goodwill was impaired and recorded a non-cash charge of $28.3 million.

Other Expenses, Net

Other expenses, net of $0.9 million and $0.5 million for the nine months ended September 30, 2013 and 2012, respectively, consist

primarily of interest charged on the outstanding borrowings under our Loan Agreement.

Income Tax Expense (Benefit)

Principally due to historical cumulative losses, substantially all of our deferred tax assets are subject to a tax valuation allowance. Although we are in a full tax valuation allowance position, a $0.4 million income tax benefit was recorded for the nine months ended September 30, 2013, primarily due to the allocation of income tax expenses between continuing and discontinued operations. For the nine months ended September 30, 2012, the income tax expense was $17.5 million on a pre-tax loss of $47.8

million.The 2012 income tax expense included $33.6 million related to the application of a valuation allowance on the Company's deferred tax assets.

Loss from Continuing Operations

We reported a loss from continuing operations of $3.4 million, or $0.40 per diluted share, in the first nine months of 2013 compared to a loss from continuing operations of $65.3 million, or $7.61 per diluted share, in the first nine months of 2012. The 2012 loss was primarily due to the impairment of goodwill, the establishment of a deferred tax valuation allowance, severance expense and additional inventory reserves associated with

discontinued products.

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Liquidity and Capital Resources

Cash and cash equivalents were $0.4 million on September 30, 2013 compared to $1.6 million on December 31, 2012. Net cash used in continuing operations of $1.3 million for the nine months ended September 30, 2013 was primarily used to fund an increase in accounts receivable of $2.9 million, reflecting increased sales during the third quarter compared to the fourth quarter of 2012, as well as a decrease in accounts payable and other liabilities. The $11.3 million of net cash used in operations in the first nine months of 2012 was primarily due to

operating losses.

Capital expenditures were $1.9 million in the first nine months of 2013 compared to $16.3 million in the first nine months of 2012. Capital expenditures in the first nine months of 2013 were primarily for warehouse equipment to support the opening of the McCook, Illinois distribution center and improvements to our sales order entry system and redesigned web-site. Capital expenditures in the first nine months of 2012 were primarily for warehouse equipment to support the McCook facility, the build-out of the new leased headquarters and expenditures related to our web-site redevelopment.

Net cash provided by financing activities included net borrowings of $2.2 million and $19.6 million in the first nine months of 2013 and 2012, respectively, primarily to support working capital requirements and capital expenditures. No dividends were paid to shareholders in the first nine months of 2013 compared to $3.1 million of dividends paid in the first nine months of 2012. Dividends are restricted under the Loan Agreement to amounts not to exceed $1.1 million per quarter subject to a formula based on EBITDA achieved in the previous quarter compared to target amounts specified in the Loan Agreement.

Loan Agreement

In addition to other customary representations, warranties and covenants, the Loan Agreement and subsequent Amendment requires us to comply with certain financial covenants. A minimum Consolidated EBITDA level, as defined in the Loan Agreement, must be achieved on a quarterly basis as detailed in the following table:

Quarter Ended	Minimum EBITDA (as Defined in the Loan Agreement)
September 30, 2013	$2,000,000
December 31, 2013	3,000,000
March 31, 2014	3,500,000
June 30, 2014	3,500,000

At September 30, 2013, EBITDA, as defined in the Loan Agreement, was $4.0 million which

was in compliance with the minimum EBITDA covenant in effect on that date. The Company anticipates that the minimum required EBITDA for future quarters will be reduced to reflect the anticipated closing on the sale of ASMP.

While the Company exceded its minimum EBITDA requirement for the quarter ended September 30, 2013, failure to meet these covenant requirements in future quarters could lead to higher financing costs, increased restrictions, or reduce or eliminate our ability to borrow funds. If we require more liquidity than is currently available to us under our Loan Agreement, we may need to

raise additional funds through debt or equity offerings which may not be available when needed or may not be available on terms favorable to us. Should funding be insufficient at any time in the future, we may be unable to develop or enhance our products or services, take advantage of business opportunities or respond to competitive pressures, any of which could have a material adverse effect on our business, financial condition and results of operations.

At September 30, 2013, we had an outstanding balance of $18.3 million under the revolving line of credit of our Loan Agreement and additional borrowing availability of $17.5 million. We believe

cash provided by operations, funds available under our Loan Agreement and anticipated proceeds from the sale of ASMP are sufficient to fund our operating requirements, strategic initiatives and capital improvements throughout the remainder of 2013.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk at September 30, 2013 from that reported in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our senior management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of

our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), as of the end of the period covered by this report (the “Evaluation Date”). Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective such that (i) the information relating to Lawson, including our consolidated subsidiaries, required to be disclosed in our SEC reports is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and

(ii) include, without limitation, controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

There was no change in the Company's internal control over financial reporting during the quarter ended September 30, 2013 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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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 906 of the Sarbanes-Oxley

	Act of 2002
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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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 24, 2013	/s/ Michael G. DeCata Michael G. DeCata President and Chief Executive Officer (principal executive officer)
Dated:	October 24, 2013	/s/ Ronald J. Knutson Ronald J. Knutson Executive Vice President and Chief Financial Officer (principal financial and accounting officer)