

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

AMENDMENT NO. 1

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2003

Commission file number 1-13293

**The Hillman Companies, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

10590 Hamilton Avenue  
Cincinnati, Ohio

(Address of principal executive offices)

23-2874736

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

45231

(Zip Code)

Registrant's telephone number, including area code: (513) 851-4900

Securities registered pursuant to Section 12(b) of the Act:

Title of Class

Name of Each Exchange on Which Registered

11.6% Junior Subordinated Debentures  
Preferred Securities Guaranty  
Preferred Share Purchase Rights

None

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

YES  NO

On November 12, 2003 there were 7,118,665 Common Shares issued and outstanding by the Registrant and 4,217,724 Trust Preferred Securities issued and outstanding by the Hillman Group Capital Trust. The Trust Preferred Securities trade on the American Stock Exchange under symbol HLM.Pr.

**Explanatory Note:**

This amendment includes changes from the previous report to reflect the impact of a restatement due to the accounting for income taxes and the valuation of a note receivable as described herein. The income tax provision for the nine months ended September 30, 2003 was increased by \$2.1 million as a result of the restatement. An additional write-down of a note receivable of \$1.4 million was recorded for the three months ended September 30, 2003. See additional disclosure in Note 1 of the Notes to Consolidated Financial Statements.

THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES

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**Item 1.****THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**  
(dollars in thousands)

	September 30, 2003 (Unaudited)	December 31, 2002
	(Restated)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,015	\$ 2,768
Restricted investments	948	1,142
Accounts receivable, net	46,276	31,855
Inventories, net	65,215	59,783
Deferred income taxes	6,654	7,663
Other current assets	2,736	3,249
Total current assets	122,844	106,460
Property and equipment, net	66,722	68,596
Goodwill	135,535	132,677
Other intangibles, net	9,952	11,068
Deferred income taxes, net	17,647	19,226
Restricted investments	5,724	5,923
Note receivable	3,600	11,258
Deferred financing fees, net	6,065	5,774
Other assets	1,129	2,212
Total assets	\$ 369,218	\$ 363,194
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 19,763	\$ 20,373
Current portion of senior term loans	9,268	9,268
Current portion of capitalized lease obligations	52	55
Accrued expenses:		
Salaries and wages	3,178	5,523
Pricing allowances	6,788	6,118
Acquisition related costs	5,822	3,395
Income and other taxes	1,644	1,329
Deferred compensation	948	1,142
Other accrued expenses	9,821	12,797
Total current liabilities	57,284	60,000
Long term senior term loans	53,607	60,559
Bank revolving credit	51,308	34,532
Long term capitalized lease obligations	157	194
Long term unsecured subordinated notes to related party	43,561	42,108
Deferred compensation	5,724	5,923
Other non-current liabilities	5,506	5,258
Total liabilities	217,147	208,574
Guaranteed preferred beneficial interests in the Company's junior subordinated debentures	102,331	102,234
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par, 1,000,000 shares authorized, none outstanding	—	—
Common stock, \$.01 par, 20,000,000 shares authorized, 7,118,665 issued and outstanding	71	71
Additional paid-in capital	52,310	52,310
Accumulated Deficit	(2,547)	—
Accumulated other comprehensive (loss) income	(94)	5
Total stockholders' equity	49,740	52,386
Total liabilities and stockholders' equity	\$ 369,218	\$ 363,194

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)  
FOR THE THREE MONTHS ENDED,  
(dollars in thousands)

	September 30, 2003	September 30, 2002
	<b>(Restated)</b>	
Net sales	\$ 86,055	\$ 75,707
Cost of sales	38,818	33,071
Gross profit	<u>47,237</u>	<u>42,636</u>
Operating expenses:		
Selling, general and administrative expenses	31,126	27,584
Depreciation	3,480	3,048
Amortization	373	371
Management fee to related party	450	450
Total operating expenses	<u>35,429</u>	<u>31,453</u>
Other income, net	459	109
Income from operations	12,267	11,292
Interest expense, net	4,101	3,268
Distributions on guaranteed preferred beneficial interests	3,058	3,058
Write-down of note receivable	1,400	—
Income before income taxes	3,708	4,966
Income tax provision	1,988	2,177
Net income	<u>\$ 1,720</u>	<u>\$ 2,789</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)  
FOR THE NINE MONTHS ENDED,  
(dollars in thousands)

	September 30, 2003	September 30, 2002
	(Restated)	
Net sales	\$ 240,307	\$ 214,910
Cost of sales	108,772	95,564
Gross profit	<u>131,535</u>	<u>119,346</u>
Operating expenses:		
Selling, general and administrative expenses	90,315	82,333
Depreciation	10,443	8,753
Amortization	1,116	1,114
Management fee to related party	1,350	1,350
Total operating expenses	<u>103,224</u>	<u>93,550</u>
Other income, net	643	1,571
Income from operations	28,954	27,367
Interest expense, net	11,656	10,039
Distributions on guaranteed preferred beneficial interests	9,174	9,172
Write-down of note receivable	7,657	—
Income before income taxes	467	8,156
Income tax provision	3,014	3,529
Net (loss) income	<u>\$ (2,547)</u>	<u>\$ 4,627</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
FOR THE NINE MONTHS ENDED,  
(dollars in thousands)

	September 30, 2003	September 30, 2002
	(Restated)	
Cash flows from operating activities:		
Net income	\$ (2,547)	\$ 4,627
Adjustments to reconcile net income to net cash (used for) provided by operating activities:		
Depreciation and amortization	11,559	9,867
Deferred income tax	2,588	3,467
PIK interest on unsecured subordinated notes	1,453	1,389
Write-down of note receivable	7,657	-
Changes in current operating items:		
Increase in accounts receivable	(14,421)	(11,884)
(Increase) decrease in inventories	(5,432)	4,713
Decrease in other current assets	939	2,122
(Decrease) increase in accounts payable	(610)	3,499
Decrease in other accrued liabilities	(4,633)	(1,505)
Other items, net	1,393	(553)
Net cash (used for) provided by operating activities	<u>(2,054)</u>	<u>15,742</u>
Cash flows from investing activities:		
Proceeds from sale of property and equipment	20	104
Capital expenditures	(8,537)	(17,714)
R&B acquisition	—	(6,225)
Other, net	471	1,037
Net cash used for investing activities	<u>(8,046)</u>	<u>(22,798)</u>
Cash flows from financing activities:		
(Repayments) borrowings of senior term loans	(6,952)	12,022
Borrowings (repayments) of revolving credit loans, net	16,776	(3,707)
Principal payments under capitalized lease obligations	(40)	(59)
Financing fees, net	(1,437)	(749)
Net cash provided by financing activities	<u>8,347</u>	<u>7,507</u>
Net (decrease) increase in cash and cash equivalents	(1,753)	451
Cash and cash equivalents at beginning of period	2,768	2,059
Cash and cash equivalents at end of period	<u>\$ 1,015</u>	<u>\$ 2,510</u>

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**1. Basis of Presentation:**

The accompanying financial statements include the consolidated accounts of The Hillman Companies, Inc. ("Hillman" or the "Company"), and its wholly owned subsidiaries including an investment trust, Hillman Group Capital Trust (the "Trust"). All significant intercompany balances and transactions have been eliminated. The Company is organized as an independently managed portfolio company of Allied Capital Corporation ("Allied Capital"). Allied Capital owns approximately 96.8% of Hillman's common stock with the remainder being held primarily by Company Management. Allied Capital's stock ownership is subject to dilution by management options.

The accompanying unaudited consolidated financial statements present information in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and applicable rules of Regulation S-X. Accordingly, they do not include all information or footnotes required by generally accepted accounting principles for complete financial statements. Management believes the financial statements include all normal recurring accrual adjustments necessary for a fair presentation. Operating results for the three and nine months ended September 30, 2003 do not necessarily indicate the results that may be expected for the full year. For further information, refer to the consolidated financial statements and notes thereto included in the Company's annual report filed on Form 10-K for the year ended December 31, 2002.

This Form 10-Q/A (Amendment No. 1) amends our previously filed Form 10-Q to restate the write-down of a note receivable for the three months ended September 30, 2003 and the income tax provision and the write-down of the note receivable from G-C Sun Holdings, L.P. ("G-C") for the nine months ended September 30, 2003. The Company has valued the G-C Note as of September 30, 2003 using the same methodology as applied in the first six months of 2003. This methodology assumed the sale of the remaining G-C business and provided for a decline in the estimated expected sale proceeds that would be available to pay our subordinated note. As a result, an additional \$1,400 write-down in the value of the G-C Note has been recorded in the three month period ended September 30, 2003. The write-down of the note results in an increase to the valuation allowance with no related tax benefit for the book-tax basis difference. As more fully described in Note 7, the Company recorded a \$6,257 charge to income during the six months ended June 30, 2003 to write-down the value of a note receivable from G-C Sun Holdings, L.P. and recognized an income tax benefit of \$2,565. As of December 31, 2002, the Company had \$36,708 of federal capital loss carryforwards available to offset future capital gains. A valuation allowance of \$9,078 had been established for \$27,298 of the capital loss carryforwards. Recognition of the remaining \$9,410 of capital loss carryforwards was deemed more likely than not based on the capital gain expected upon the proceeds from the repayment of the G-C Note. However, the reduction in the value of the G-C Note reduced the expected utilization of the capital loss carryforwards by the amount of the write-down and a valuation allowance should have been recorded. Accordingly, the income tax provision in the accompanying Consolidated Statements of Operations for the nine month period ended September 30, 2003 has been restated to increase the valuation allowance by \$2,050. In addition, deferred tax asset amounts have been reclassified for the pro-rata allocation of the valuation allowance between current and long-term deferred tax assets.



**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands)

**1. Basis of Presentation (continued):**

The impact of the restatement on the restated components of the Company's consolidated balance sheet is as follows (in thousands):

	<u>As Reported</u>	<u>As Restated</u>
<u>September 30, 2003:</u>		
Deferred income tax assets - current (a)	\$ 10,285	\$ 6,654
Current assets	126,475	122,844
Deferred income tax assets - long-term (a)	21,829	17,647
Note receivable	5,000	3,600
Total assets	378,431	369,218
Deferred income tax liabilities - long-term (a)	5,763	—
Total liabilities	222,910	217,147
Retained earnings (accumulated deficit)	903	(2,547)
Total stockholders' equity	53,190	49,740
Total liabilities and stockholders' equity	378,431	369,218

The impact of the restatement on the restated components of the Company's consolidated statement of operations is as follows (in thousands):

	<u>As Reported</u>	<u>As Restated</u>
<u>For the three months ended September 30, 2003:</u>		
Write-down of note receivable	\$ —	\$ 1,400
Income before income taxes	5,108	3,708
Net income	3,120	1,720
<u>For the nine months ended September 30, 2003:</u>		
Write-down of note receivable	6,257	7,657
Income before income taxes	1,867	467
Income tax provision	964	3,014
Net income (loss)	903	(2,547)

- (a) A reclassification in the amount of \$5,763 has been recorded to present the restated deferred income tax assets - long-term net of deferred income tax liability as of September 30, 2003.

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands)

**1. Basis of Presentation (continued):**

**Other Intangible Assets**

Intangible assets subject to amortization consisted of the following as of September 30, 2003:

	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>
Trademarks	\$ 6,500	\$ 910
Patents	6,700	2,931
Proprietary software	1,000	438
Non-compete agreements	1,250	1,219
	<u>\$15,450</u>	<u>\$ 5,498</u>

Amortization expense for intangible assets for the three and nine months ended September 30, 2003 was \$373 and \$1,116, respectively. Amortization expense for the next five years is estimated to be as follows:

<u>Year Ended December 31</u>	<u>Amount</u>
2003	\$1,437
2004	\$1,238
2005	\$1,223
2006	\$1,222
2007	\$1,223

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**2. Summary of Significant Accounting Policies:**

**Cash Equivalents:**

Cash equivalents consist of commercial paper, U.S. Treasury obligations and other liquid securities purchased with initial maturities less than 90 days and are stated at cost which approximates market value.

**Restricted Investments:**

Restricted investments represent assets held in a Rabbi Trust to fund deferred compensation liabilities due to certain Company employees.

**Inventories:**

Inventories consisting predominantly of finished goods are valued at the lower of cost or market, cost being determined principally on the first-in, first-out method.

**Property and Equipment:**

Property and equipment, including assets acquired under capital leases, are carried at cost and include expenditures for new facilities and major renewals. Maintenance and repairs are charged to expense as incurred. The cost and related accumulated depreciation are removed from their respective accounts when assets are sold or otherwise disposed of and the resulting gain or loss is reflected in current operations.

**Depreciation:**

For financial accounting purposes, depreciation, including that related to plant and equipment acquired under capital leases, is computed on the straight-line method over the estimated useful lives of the assets, generally three to ten years, or, if shorter, over the terms of the related leases.

**Long-Lived Assets:**

Under the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company has evaluated its long-lived assets for financial impairment and will continue to evaluate them based on the estimated undiscounted future cash flows as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

**Income Taxes:**

Deferred income taxes are computed using the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities (temporary differences) and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided for tax benefits where it is more likely than not that certain future tax benefits will not be realized. Adjustments to valuation allowances are recorded from changes in utilization of the tax related item.

**Retirement Benefits:**

Certain employees of the Company are covered under a profit-sharing and retirement savings plan (the "plan"). The plan provides for a matching contribution for eligible employees of 50% of each dollar contributed by the employee up to 6% of employee's compensation. In addition, the plan provides an annual contribution in amounts authorized by the Board, subject to the terms and conditions of the plan.

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands)

**2. Summary of Significant Accounting Policies (continued):**

**Revenue Recognition:**

Revenue from sales of products is recorded upon the passing of title and risks of ownership which occurs upon the shipment of goods. Revenue is recorded net of pricing allowances such as customer rebates and discounts.

**Shipping and Handling:**

The costs incurred to ship product to customers, including freight and handling expenses, are included in selling, general and administrative ("SG&A") expenses on the Company's Statements of Operations. For the three months ended September 30, 2003 and 2002, shipping and handling costs included in SG&A were \$4,044 and \$3,704, respectively. For the nine months ended September 30, 2003 and 2002, shipping and handling costs included in SG&A were \$11,906 and \$10,380, respectively.

**Research and Development:**

The Company incurs research and development costs in connection with improvements to the key duplicating and engraving machines. For the three months ended September 30, 2003 and 2002, research and development expenses, consisting primarily of internal wages and benefits, were \$424 and \$413, respectively. For the nine months ended September 30, 2003 and 2002, research and development expenses were \$1,148 and \$1,166, respectively.

**Translation of Foreign Currencies:**

The translation of the Company's Canadian foreign currency based financial statements into U.S. dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period.

**Comprehensive Income:**

The components of comprehensive income (loss) for the three and nine months ended September 30, 2003 and 2002 were as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2003	2002	2003	2002
Net income (loss)	\$ 1,720	\$ 2,789	\$ (2,547)	\$ 4,627
Foreign currency translation adjustment	1	7	(99)	3
Comprehensive income (loss)	<u>\$ 1,721</u>	<u>\$ 2,796</u>	<u>\$ (2,646)</u>	<u>\$ 4,630</u>

**Use of Estimates in the Preparation of Financial Statements:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(dollars in thousands)

**2. Summary of Significant Accounting Policies (continued):**

**Reclassifications:**

Certain amounts in our 2002 consolidated financial statements have been reclassified to conform to the 2003 presentation.

**3. Acquisitions:**

On May 1, 2002, the Company purchased certain assets of the Lowe's specialty fastener business from R&B, Inc. for cash consideration of \$6,207. On October 3, 2002, the Company purchased the net assets of the DIY division ("DIY") of the Fastenal Company for cash consideration of \$15,218. The following disclosures indicate the Company's estimate of pro forma financial results for the three and nine month periods ended September 30, 2002 had the acquisitions of the Lowe's specialty fastener business and the DIY business been consummated on January 1, 2002:

	Three months ended September 30, 2002	Nine months ended September 30, 2002
Net sales	\$ 80,734	\$ 232,229
Net income	\$ 2,909	\$ 5,216

In connection with the DIY acquisition, the Company developed an overall integration plan that included the elimination of redundant headcount and facilities. In accordance with ETIF No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," the Company accrued approximately \$3,400 of estimated costs related to the integration plan in the fourth quarter of 2002. The estimated costs consisted of approximately \$1,500 of fixed asset disposals, \$900 of facilities costs, \$500 of moving expenses and \$500 for planned workforce reductions. The integration is expected to be implemented beginning in the fourth quarter of 2003 and be substantially completed by the end of the first quarter of 2004.

Additional reserves have been established in the second quarter of 2003 for costs associated with the integration of the DIY acquisition. Additional costs include severance of \$207, inventory adjustments of \$1,200, and customer conversion costs which include product buybacks of \$1,450.

The following table provides a rollforward from December 31, 2002 to September 30, 2003 of the remaining liabilities and acquisition related charges recorded by the Company:

	Severance & Related Costs	Facility Lease	Inventory Adjustments	Fixed Asset Disposal	Customer Conversions	Total
Balances at December 31, 2002	\$ 495	\$ 900	\$ 500	\$ 1,500	\$ —	\$3,395
Additions	—	—	—	—	—	—
Payments	(13)	—	—	—	—	(13)
Balances at March 31, 2003	482	900	500	1,500	—	3,382
Additions	207	—	1,200	—	1,450	2,857
Payments	(14)	—	—	—	—	(14)
Balances at June 30, 2003	675	900	1,700	1,500	1,450	6,225
Additions	—	—	—	—	—	—
Payments	—	—	(122)	—	(281)	(403)
Balances at September 30, 2003	<u>\$ 675</u>	<u>\$ 900</u>	<u>\$ 1,578</u>	<u>\$ 1,500</u>	<u>\$ 1,169</u>	<u>\$5,822</u>

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**4. Contingencies:**

Under the Company's insurance programs, commercial umbrella coverage is obtained for catastrophic exposure and aggregate losses in excess of normal claims. Beginning in 1991, the Company has retained risk on certain expected losses from both asserted and unasserted claims related to worker's compensation, general liability and automobile as well as the health benefits of certain employees. Provisions for losses expected under these programs are recorded based on an analysis of historical insurance claim data and certain actuarial assumptions. As of September 30, 2003, the Company has provided insurers letters of credit aggregating \$3,857 related to certain insurance programs.

Legal proceedings are pending which are either in the ordinary course of business or incidental to the Company's business. Those legal proceedings incidental to the business of the Company are generally not covered by insurance or other indemnity. In the opinion of management, the ultimate resolution of the pending litigation matters should not have a material adverse effect on the consolidated financial position, operations or cash flows of the Company.

**5. Related Party Transactions:**

On September 26, 2001, the Company was acquired by Allied Capital pursuant to the terms and conditions of an Agreement and Plan of Merger dated as of June 18, 2001. In connection with the Merger Transaction, the Company is obligated to pay management fees to a subsidiary of Allied Capital for management services rendered in the amount of \$1,800 for calendar years subsequent to 2001. The Company has recorded a management fee charge of \$450 for the three months and \$1,350 for the nine months ended September 30, 2003 and 2002. Payment of management fees is due annually after delivery of the Company's annual audited financial statements to the Board of Directors of the Company. The management fee for the year ended December 31, 2002 was paid in April 2003.

The Company incurs interest expense to Allied Capital on the subordinated debt at a fixed rate of 18.0% per annum. Cash interest payments are required on a quarterly basis at a fixed rate of 13.5% with the remaining 4.5% fixed rate (the "PIK Amount") being added to the principal balance. As of September 30, 2003, the outstanding subordinated debt including the PIK amounts was \$43,561.

**6. Recent Accounting Pronouncements:**

In November 2002, the FASB issued Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 requires that a guarantor must recognize, at the inception of a guarantee, a liability for the fair value of the obligation that it has undertaken in issuing a guarantee. FIN No. 45 also addresses the disclosure requirements that a guarantor must include in its financial statements for guarantees issued. The disclosure requirements in this interpretation are effective for financial statements ending after December 15, 2002. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The Company adopted the provisions of FIN No. 45 effective January 1, 2003. The adoption of FIN 45 did not have an impact on the Company's consolidated financial position, results of operations or cash flows.

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**6. Recent Accounting Pronouncements (continued):**

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities" (an interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements"). FIN No. 46 addresses consolidation by business enterprises of variable interest entities that possess certain characteristics. FIN No. 46 requires that if a business enterprise has a controlling financial interest in a variable interest entity, the assets, liabilities, and results of the activities of the variable interest entity must be included in the consolidated financial statements with those of the business enterprise. On October 8, 2003, the FASB deferred the effective date for variable interest entities that existed prior to January 31, 2003. FASB Staff Position FIN 46-6 ("FIN 46-6") establishes the first interim or annual period ending after December 15, 2003 as the new effective date for variable interest entities that existed prior to January 31, 2003. The Company has elected to defer adoption of FIN No. 46 pending final resolution of the issues currently under discussion at the FASB.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS No. 145"). Among other items, SFAS No. 145 updates and clarifies existing accounting pronouncements related to reporting gains and losses from the extinguishment of debt and certain lease modifications that have economic effects similar to sale-leaseback transactions. The provisions of SFAS No. 145 are generally effective for fiscal years beginning after May 15, 2002, with earlier adoption of certain provisions encouraged. The Company adopted the provisions of SFAS No. 145 effective January 1, 2003. The adoption of SFAS No. 145 did not have an impact on the Company's consolidated financial position, results of operations or cash flows.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF Issue 94-3, a liability for an exit cost as defined in EITF Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with earlier application encouraged. Under SFAS No. 146, an entity may not restate its previously issued financial statements and the new statement grandfathers the accounting for liabilities that an entity had previously recorded under EITF Issue 94-3. The Company adopted the provisions of SFAS No. 146 effective January 1, 2003. The adoption of SFAS No. 146 did not have an impact on the Company's consolidated financial position, results of operations, or cash flows.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure" ("SFAS No. 148"). SFAS No. 148 amends FASB Statement No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the prior disclosure guidance and requires prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of SFAS No. 148 are generally effective for fiscal years ending after December 15, 2002. At this time the Company does not plan to adopt the accounting provisions of SFAS No. 123 and will continue to account for stock options in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees."

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**6. Recent Accounting Pronouncements (continued):**

In May 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have an impact on the Company's consolidated financial position, results of operations, or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." The statement requires that an issuer classify financial instruments that are within its scope as a liability. Many of those instruments were classified as equity under previous guidance. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for certain mandatorily redeemable financial instruments. On November 7, 2003, the FASB indefinitely deferred the effective date of SFAS No. 150 for certain mandatorily redeemable financial instruments and therefore the Company has elected to defer adoption.

**7. Note Receivable:**

On April 13, 2002, the Company entered into a Unit Repurchase Agreement with GC-Sun Holdings, L.P., pursuant to which G-C exercised its call right under the G-C partnership agreement to purchase the Company's interest in G-C. The Unit Repurchase Agreement closed on June 25, 2002. In exchange for its interest in G-C, the Company received a \$10,000 subordinated note from G-C. Interest on the note is payable quarterly at a rate of 18% from May 1, 2002 to April 30, 2003, 17% from May 1, 2003 to April 30, 2004, and 16% thereafter. G-C's payment of interest on the note is subject to certain restrictions under the terms of the subordinated note agreement. If such restrictions do not permit the current payment of interest in cash when due, accrued interest is added to the principal.

In February 2003, G-C sold the assets of its largest operating division, Kar Products. The proceeds of the sale were primarily used to pay down G-C's senior creditors. Following the sale of Kar Products, the Company estimated the enterprise value of G-C based on the cash flows and book value of the remaining operating division under a held for sale methodology. The excess of the estimated enterprise value less debt obligations senior to the G-C note were determined to be insufficient to support the value of the G-C note. Accordingly, the Company recorded a \$5,657 charge to income in the first quarter of 2003 to write-down the face value of the note and accrued interest thereon to its estimated future cash flows. The Company recorded additional charges to income of \$600 in the second quarter of 2003 and \$1,400 in the third quarter of 2003 for changes in the assessments of the estimated amounts recoverable under the note.



**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(dollars in thousands)**

**8. Financing Fees:**

On September 28, 2001, the Company entered into a \$105,000 senior secured credit facility (the "Credit Agreement") consisting of \$50,000 revolving credit (the "Revolver"), a \$20,000 term loan (the "Term Loan A"), and a \$35,000 term loan (the "Term Loan B"). This Credit Agreement has a five-year term for the Revolver and Term Loan A and a seven-year term for Term Loan B.

On May 1, 2002 the Credit Agreement was amended to provide an additional \$10,000 of availability under the revolving credit facility and to increase Term Loan A by \$15,000. Proceeds were used to fund the expansion and automation of the Company's Cincinnati distribution center and to purchase certain assets of the Lowe's specialty fastener business from R&B, Inc.

On December 23, 2002 the Credit Agreement was amended to provide an additional \$4,780 of availability under the revolving credit agreement and to increase Term Loan A by \$2,500 and Term Loan B by \$2,720. The proceeds were used to fund the previously completed acquisition of the DIY Business.

In May 2003, the Company made additional payments in the amount of \$1,420 in connection with the Company's 2001 Credit Agreement. The payments were capitalized as deferred financing fees and are being amortized over the remaining term of the Revolver, Term Loan A and Term Loan B.

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

As discussed in Note 1, the impact of the restatement on the restated components of the Company's consolidated balance sheet is as follows (in thousands):

	<u>As Reported</u>	<u>As Restated</u>
<u>September 30, 2003:</u>		
Deferred income tax assets - current (a)	\$ 10,285	\$ 6,654
Current assets	126,475	122,844
Deferred income tax assets - long-term (a)	21,829	17,647
Note receivable	5,000	3,600
Total assets	378,431	369,218
Deferred income tax liabilities - long-term (a)	5,763	—
Current liabilities	222,910	217,147
Retained earnings (accumulated deficit)	903	(2,547)
Total stockholders' equity	53,190	49,740
Total liabilities and stockholders' equity	378,431	369,218

The impact of the restatement on the restated components of the Company's consolidated statement of operations is as follows (in thousands):

	<u>As Reported</u>	<u>As Restated</u>
<u>For the three months ended September 30, 2003:</u>		
Write-down of note receivable	\$ —	\$ 1,400
Income before income taxes	5,108	3,708
Net income	3,120	1,720
<u>For the nine months ended September 30, 2003:</u>		
Write-down of note receivable	6,257	7,657
Income before income taxes	1,867	467
Income tax provision	964	3,014
Net income (loss)	903	(2,547)

- (a) A reclassification in the amount of \$5,763 has been recorded to present the restated deferred income tax assets — long-term net of deferred income tax liability as of September 30, 2003.

The following discussion provides information which management believes is relevant to an assessment and understanding of the Company's operations and financial condition. This discussion should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere herein.

**General**

The Hillman Companies, Inc. ("Hillman" or the "Company"), is one of the largest providers of value-added merchandising services and hardware-related products to retail markets in North America.

The Company, through its wholly owned subsidiary, The Hillman Group, Inc. (the "Hillman Group") provides merchandising services and hardware and related products, such as, fasteners and similar items, key duplication equipment, keys and related accessories and identification equipment and items to retail outlets, primarily hardware stores, home centers and mass merchants.

Hillman is organized as an independently managed portfolio company of Allied Capital Corporation ("Allied Capital"). Allied Capital owns approximately 96.8% of Hillman's common stock with the remainder being held primarily by Company Management.

### ***Financing Arrangements***

On December 28, 2000, the Company issued \$30 million of unsecured subordinated notes to Allied Capital and issued an additional \$10 million of these notes to Allied Capital on September 28, 2001 (the "Amended Subordinated Debt Issuance"). The majority of the cash proceeds generated from the Amended Subordinated Debt Issuance were used to repay at a discount an unsecured subordinated note issued in connection with the acquisition of Axxess Technologies, Inc. on April 7, 2000 (the "Axxess Subordinated Note Repayment").

On September 28, 2001, the Company refinanced its \$115 million bank revolving credit and \$21.5 million term loan with \$105 million in senior secured credit facilities (the "Refinancing"). The new senior debt agreement ("Credit Agreement") has a \$50 million revolving credit line, a \$20 million term loan that expires on September 27, 2006, and a \$35 million term loan that expires on September 27, 2008.

On May 1, 2002, the Credit Agreement was amended to provide an additional \$10.0 million of availability under the revolving credit facility and to increase the term loans by \$15.0 million. Proceeds of the additional financing were used to finance the purchase of the specialty fastener business of Lowe's, Inc. from R&B, Inc., the settlement of litigation with R&B, Inc. and the expansion and automation of the Company's distribution facilities.

On December 23, 2002, the Credit Agreement was amended to provide an additional \$4.8 million of availability under the revolving credit agreement and to increase the term loans by \$5.2 million. As of September 30, 2003, the outstanding balance of the term loans aggregated \$62.9 million.

The Company pays interest to the Trust on the Junior Subordinated Debentures underlying the Trust Preferred Securities at the rate of 11.6% per annum on their face amount of \$105.4 million, or \$12.2 million per annum in the aggregate. The Trust distributes an equivalent amount to the holders of the Trust Preferred Securities.

### ***Acquisitions***

On May 1, 2002, the Company purchased certain assets of the Lowe's specialty fastener business from R&B, Inc. for cash consideration of \$6,207. On October 3, 2002, the Company purchased the net assets of the DIY division ("DIY") of the Fastenal Company for cash consideration of \$15,218.

## Results of Operations

### Three Months Ended September 30, 2003 and 2002

Net sales increased \$10.4 million or 13.7% in the third quarter of 2003 to \$86.1 million from \$75.7 million in 2002. Sales to national accounts represented \$2.7 million of the \$10.4 million total sales increase in the third quarter primarily as a result of increased fastener sales to Lowe's and increased keys and letters, numbers, and signs ("LNS") sales to Home Depot. In October 2002, Hillman acquired the DIY division ("DIY") of the Fastenal Company which contributed fastener related sales of \$4.3 million in the third quarter of 2003. Other sales, including regional accounts and engraving products were up \$2.3 million compared to the third quarter of 2002. In addition, franchise and independent ("F&I") accounts increased \$1.1 million from the comparable period in 2002. The F&I accounts are typically individual hardware dealers who are members of larger cooperatives, such as TruServ, Ace, and Do-It-Best.

The Hillman Group's gross profit was 54.9% in the third quarter of 2003 compared to 56.3% in the third quarter of 2002. The margin rate decrease from the prior year was the result of lower margins on the newly acquired DIY business.

The Company's consolidated selling, general and administrative expenses ("S,G&A") increased \$3.5 million or 12.7% from \$27.6 million in the third quarter of 2002 to \$31.1 million in the third quarter of 2003. Selling expenses increased \$1.7 million or 12.9% primarily as a result of an increase in displays, fixtures and service labor for newly opened national account locations and conversion of merchant displays in existing locations. Warehouse and delivery expenses increased \$1.8 million or 20.9% primarily as a result of increased freight and labor of \$1.4 million on increased sales volume and labor and other costs of \$0.4 million related to operation of the new distribution facility in 2003. General and administrative expenses increased by \$0.1 million or 1.8% primarily as a result of an increase in the Company's medical claims cost.

Total S,G&A expenses in the third quarter of 2003 expressed as a percentage of sales compared with the third quarter of 2002 are as follows:

As a % of Sales	Three Months ended Sept. 30,	
	2003	2002
Selling Expenses	17.3%	17.5%
Warehouse and Delivery Expenses	12.1%	11.4%
General and Administrative Expenses	6.8%	7.5%
Total S,G&A Expenses	36.2%	36.4%

Income from operations for the third quarter of 2003 was \$12.3 million compared with \$11.3 million for the same prior-year period, representing an increase of 8.8%.

The Company's consolidated operating profit margin (income from operations as a percentage of sales) decreased to 14.3% in the third quarter of 2003 compared with 14.9% in 2002. The operating profit margin decrease was the result of the decrease in gross profit which was partially offset by a decrease in operating expenses and an increase in other income expressed as a percentage of sales. The gross profit rate decrease from the comparable prior year period was the result of lower margins on the newly acquired DIY business. Other income increased in the third quarter of 2003 from a \$0.4 million gain recorded as a result of a payout received from the Company's former insurance company upon its demutualization.

Depreciation expense increased \$0.5 million to \$3.5 million in the third quarter of 2003 from \$3.0 million in the same quarter of 2002.

Amortization expense of \$0.4 million in the third quarter of 2003 was equal to the amortization in the same quarter of 2002.

The Company has recorded a management fee charge of \$0.45 million for the third quarters of 2003 and 2002, respectively. The Company is obligated to pay management

fees to a subsidiary of Allied Capital for management services rendered in the amount of \$1.8 million for calendar years subsequent to 2001. The payment of management fees is due annually after delivery of the Company's annual audited financial statements to the Board of Directors of the Company. The management fee for the year ended December 31, 2002 was paid in April, 2003.

In February 2003, G-C Sun Holdings, L.P. ("G-C") sold the assets of its largest operating division, Kar Products. The proceeds of the sale were primarily used to pay down G-C's senior creditors. Following the sale of Kar Products, the Company estimated the enterprise value of G-C based on the cash flows and book value of the remaining operating division. The excess of the estimated enterprise value less debt obligations senior to the G-C note were determined to be insufficient to support the value of the G-C note. Accordingly, the Company recorded a \$5.7 million charge to income in the first quarter of 2003 to write-down the face value of the note and accrued interest thereon to its estimated future cash flows. The Company recorded additional charges to income of \$0.6 million in the second quarter of 2003 and \$1.4 million in the third quarter of 2003 for changes in the assessments of the estimated amounts recoverable under the note.

Interest expense from credit facilities, net of interest income, increased \$0.8 million to \$4.1 million in the third quarter of 2003 from \$3.3 million in the same period of 2002. The interest expense increase was the result of additional borrowings used to finance the expansion and automation of the Company's distribution facility and to purchase two businesses in 2002. A reduction in interest income of \$0.5 million resulted from the suspension of interest income on the subordinated note received from G-C.

For the three months ended September 30, 2003 and 2002, the Company paid \$3.1 million in interest on the Junior Subordinated Debentures, equivalent to the amounts distributed by the Trust on the Trust Preferred Securities.

The Company is subject to federal, state and local income taxes on its domestic operations and foreign income taxes on its Canadian operation as accounted for in accordance with Statement of Financial Accounting Standard (SFAS) No. 109, "Accounting for Income Taxes." Deferred income taxes represent differences between the financial statement and tax basis of assets and liabilities as classified on the Company's balance sheet. The Company recorded a tax provision for income taxes of \$2.0 million on pre-tax income of \$3.7 million in the third quarter of 2003. The effective tax rate in the third quarter of 2003 was 53.6% compared to 43.8% in the third quarter of 2002. The change in the effective tax rate resulted from the increase in income before taxes in the third quarter of 2003 compared with the third quarter of 2002 and a decrease in the change of permanent tax items in 2003, which includes the write-down on the face of the G-C Note, when compared to 2002.

#### **Nine Months Ended September 30, 2003 and 2002**

Net sales increased \$25.4 million or 11.8% in the first nine months of 2003 to \$240.3 million from \$214.9 million in 2002. Sales to national accounts represented \$9.2 million of the \$25.4 million total sales increase in the first nine months primarily as a result of increased fastener sales to Lowe's and increased keys and letters, numbers, and signs ("LNS") sales to Home Depot. In October 2002, Hillman acquired the DIY division ("DIY") of the Fastenal Company which contributed fastener related sales of \$12.8 million in the first nine months of 2003. Other sales, including regional accounts and engraving products were up \$5.0 million compared to the first nine months of 2002. Franchise and independent ("F&I") accounts decreased \$1.6 million from the comparable period in 2002. The F&I accounts are typically individual hardware dealers who are members of larger cooperatives, such as TruServ, Ace, and Do-It-Best. The F&I business decline was primarily the result of the unseasonal weather conditions, consumer uncertainties related to the war in Iraq and unfavorable economic conditions during the first half of the year. The F&I sales decline in the first half of 2003 compared to 2002 reversed direction as the economy began to show signs of recovery.

The Hillman Group's gross profit was 54.7% in the first nine months of 2003 compared to 55.5% in the first nine months of 2002. The margin rate decrease from the prior year was the result of lower margins on the newly acquired DIY business.

The Company's consolidated selling, general and administrative expenses ("S,G&A") increased \$8.0 million or 9.7% from \$82.3 million in the first nine months of 2002 to \$90.3 million in the first nine months of 2003. Selling expenses increased \$1.4 million or 3.4% primarily as a result of an increase in displays, fixtures and service labor for newly opened national account locations and conversion of merchant displays in existing locations. Warehouse and delivery expenses increased \$5.8 million or 23.8% primarily as a result of increased freight and labor of \$3.4 million on increased sales volume and labor and other costs of \$1.6 million related to start up of the new distribution facility in 2003. The start up costs associated with the new distribution facility moderated in the second and third quarters and management does not expect these costs to be material in the fourth quarter. General and administrative expenses increased by \$0.7 million or 4.2% primarily as a result of an increase in the Company's medical claims cost which was partially offset by a reduction in corporate overhead costs following elimination of the Philadelphia corporate office in May 2002. Medical expenses for the first nine months of 2003 include \$1.5 million of claims paid under the Company's group medical insurance plan, which involved claims by an employee for medical services performed at the end of 2002. Management does not anticipate further medical expense of a material amount in connection with these claims.

Total S,G&A expenses in the first nine months of 2003 expressed as a percentage of sales compared with the first nine months of 2002 are as follows:

As a % of Sales	Nine Months ended Sept. 30,	
	2003	2002
Selling Expenses	17.8%	19.3%
Warehouse and Delivery Expenses	12.6%	11.3%
General and Administrative Expenses	7.2%	7.7%
Total S,G&A Expenses	37.6%	38.3%

Income from operations for the first nine months of 2003 was \$29.0 million compared with \$27.4 million for the same prior-year period, representing an increase of 5.8%.

The Company's consolidated operating profit margin (income from operations as a percentage of sales) was 12.0% in the first nine months of 2003 compared with 12.7% in 2002. The operating profit margin reduction was due primarily to the decrease in gross profit and the increase in depreciation expense expressed as a percentage of sales. In addition, the favorable effect of a reduction in S,G&A expenses as a percentage of sales was offset by a corresponding decrease in other income compared to the prior year. The gross profit rate decrease from the comparable prior year period was the result of lower margins on the newly acquired DIY business. The increase in depreciation expense for the first nine months of 2003 compared to the prior year period was due to the increase in depreciable fixed assets for the new distribution facility placed into service in January 2003 and increased key machine placements. The smaller S,G&A expense as a percentage of sales in 2003 was due to a reduction in costs associated with promotional marketing materials and corporate overhead expenses. Other income was reduced in the first nine months of 2003 as a result of the \$1.2 million gain on termination of the STS pension plan recorded in the prior year compared to the \$0.4 gain from the payment received in 2003 from General American Insurance Company upon its demutualization.

Depreciation expense increased \$1.6 million to \$10.4 million in the first nine months of 2003 from \$8.8 million in the same period of 2002.

Amortization expense of \$1.1 million in the first nine months of 2003 was equal to the amortization in the same period of 2002.

The Company has recorded a management fee charge of \$1.4 million for the first nine months of 2003 and 2002, respectively. The Company is obligated to pay management fees

to a subsidiary of Allied Capital for management services rendered in the amount of \$1.8 million for calendar years subsequent to 2001. The payment of management fees is due annually after delivery of the Company's annual audited financial statements to the Board of Directors of the Company. The management fee for the year ended December 31, 2002 was paid in April, 2003.

In February 2003, G-C sold the assets of its largest operating division, Kar Products. The proceeds of the sale were primarily used to pay down G-C's senior creditors. Following the sale of Kar Products, the Company estimated the enterprise value of G-C based on the cash flows and book value of the remaining operating division. The excess of the estimated enterprise value less debt obligations senior to the G-C note were determined to be insufficient to support the value of the G-C note. Accordingly, the Company recorded a \$5.7 million charge to income in the first quarter of 2003 to write-down the face value of the note and accrued interest thereon to its estimated future cash flows. The Company recorded additional charges to income of \$0.6 million in the second quarter of 2003 and \$1.4 million in the third quarter of 2003 for changes in the assessments of the estimated amounts recoverable under the note.

Interest expense from credit facilities, net of interest income, increased \$1.7 million to \$11.7 million in the first nine months of 2003 from \$10.0 million in the same period of 2002. The increase was primarily the result of additional borrowings to finance the expansion and automation of the Company's distribution facility, to purchase the Lowe's specialty fastener business from R&B, Inc. in May 2002, and to purchase the DIY business from Fastenal Company in October 2002. A reduction in interest income of \$0.8 million resulted from the suspension of interest income on the subordinated note received from G-C.

For the nine months ended September 30, 2003 and 2002, the Company paid \$9.2 million in interest on the Junior Subordinated Debentures, equivalent to the amounts distributed by the Trust on the Trust Preferred Securities.

The Company is subject to federal, state and local income taxes on its domestic operations and foreign income taxes on its Canadian operation as accounted for in accordance with Statement of Financial Accounting Standard (SFAS) No. 109, "Accounting for Income Taxes." Deferred income taxes represent differences between the financial statement and tax basis of assets and liabilities as classified on the Company's balance sheet. The Company recorded a tax provision for income taxes of \$3.0 million on pre-tax income of \$0.5 million in the first nine months of 2003. The effective tax rate in the first nine months of 2003 was 645.4% compared to 43.3% in the first nine months of 2002. The increase in the effective tax rate was the result of the decrease in income before taxes in 2003 as compared to 2002 together with an increase in the permanent tax items which include the write-down on the face of the G-C Note.

### **Cash Flows**

The statements of cash flows reflect the changes in cash and cash equivalents for the nine months ended September 30, 2003 and 2002 by classifying transactions into three major categories: operating, investing and financing activities.

### **Operating Activities**

The Company's main source of liquidity is cash generated from operating activities consisting of net earnings from operations adjusted for non-cash operating items such as depreciation and changes in operating assets and liabilities such as receivables, inventories and payables.

Cash used by operating activities for the first nine months of 2003 was \$2.1 million compared to cash provided of \$15.7 million in the same prior year period. The negative net change of \$17.8 million in the current nine months compared to the same period in 2002 was primarily due to the use of \$13.9 million more operating cash to fund the increased inventory, accounts receivable, and other asset requirements. The increased inventory was used to facilitate the transition of sales order volume from the Company's Tempe facility to the new Cincinnati distribution facility and to support the Company's increased sales volume. The transition of sales order volume was

substantially complete as of September 30, 2003. The accounts receivable increase in 2003 compared to 2002 was also a function of higher sales levels. An additional \$2.1 million more operating cash was used this year to fund the higher customer pricing allowances earned and accrued in 2002, but paid in 2003. The sales improvement recorded in 2002 produced the increased amount of customer allowances paid in 2003.

#### Investing Activities

The principal recurring investing activities are property additions primarily for key duplicating machines. Net property additions for the first nine months of 2003 were \$8.5 million compared to \$17.7 million in the comparable prior year period. The decrease in capital expenditures in the first nine months of 2003 compared to the prior year period results from a decrease in the amount of expenditures for the automated distribution center in Cincinnati which was completed in November 2002 and placed into service in January 2003.

#### Financing Activities

Net borrowings under the Company's senior credit facilities of \$8.3 million for the nine months ended September 30, 2003 increased \$0.8 million from the comparable prior year period as a result primarily of cash flow used for operations.

#### Liquidity and Capital Resources

The Company's working capital position (defined as current assets less current liabilities) of \$65.6 million at September 30, 2003 represents an increase of \$19.1 million from the December 31, 2002 level of \$46.5 million primarily as a result of the seasonal increase in accounts receivable of \$14.4 million and an inventory increase of \$5.4 million resulting from seasonal requirements as well as a build up of stock to facilitate the transition of sales order volume from the Company's Tempe facility to the new Cincinnati distribution center. The Company's current ratio (defined as current assets divided by current liabilities) increased to 2.14x at September 30, 2003 from 1.77x at December 31, 2002.

The Company's contractual obligations in thousands of dollars as of September 30, 2003 are summarized below:

	Total	Less Than One Year	Payments Due	
			1 to 3 Years	More Than 3 Years
<b>Contractual Obligations</b>				
Guaranteed Preferred Beneficial Interests in the Company's Junior Subordinated Debentures	\$105,446	—	—	\$105,446
Long Term Senior Term Loans	62,875	\$ 9,268	\$ 18,537	35,070
Bank Revolving Credit Facility	51,308	—	—	51,308
Long Term Unsecured Subordinated Notes	43,561	—	—	43,561
Operating Leases	32,509	6,756	10,015	15,738
Deferred Compensation Obligations	6,672	948	1,896	3,828
Capital Lease Obligations	209	66	105	38
Other Long Term Obligations	6,902	1,696	1,955	3,251
Total Contractual Cash Obligations	<u>\$309,482</u>	<u>\$ 18,734</u>	<u>\$ 32,508</u>	<u>\$ 258,240</u>

All of the obligations noted above are reflected on the Company's Consolidated Balance Sheet as of September 30, 2003, except for the Operating Leases.

As of September 30, 2003, the Company had \$9.6 million available under its secured credit facilities. The Company had approximately \$114.4 million of outstanding debt under its secured credit facilities at September 30, 2003, consisting of \$62.9 million in term loans, \$51.3 million in revolving credit borrowings and \$0.2 million in capitalized lease obligations. The term loans consisted of a \$36.7 million Term B Loan (the "Term Loan B") currently at a three (3) month LIBOR rate of 4.94% and a \$26.2 million Term A loan (the "Term Loan A") at a one (1) month LIBOR rate of 4.625%. The



revolver borrowings (the "Revolver") consist of \$20.0 million currently at a two (2) month LIBOR rate of 4.625%, \$14.0 million at a three (3) month LIBOR rate of 4.6875%, \$15.0 million at a three (3) month LIBOR rate of 4.625% and \$2.3 million at the prime rate of 6.00%. The capitalized lease obligations were at various interest rates.

As of September 30, 2003 the Company had no material purchase commitments for capital expenditures.

Interest on the Amended Subordinated Debt Issuance of \$40 million which matures September 29, 2009 is at a fixed rate of 18.0% per annum, with cash interest payments being required on a quarterly basis at a fixed rate of 13.5% commencing November 15, 2001. The outstanding principal balance of the Amended Subordinated Debt Issuance shall be increased on a quarterly basis at the remaining 4.5% fixed rate (the "PIK Amount"). All of the PIK Amounts are due on the fifth anniversary of the Amended Subordinated Debt Issuance. As of September 30, 2003, the outstanding Amended Subordinated Debt Issuance including the PIK Amounts was \$43.6 million.

The Senior Credit Agreement, among other provisions, contains financial covenants requiring the maintenance of specific ratios and levels of financial position, restricts the incurrence of additional debt, and the sale of assets, and permits acquisitions only with the consent of the lenders. The Company was in full compliance with all provisions of the Senior Credit Agreement as of September 30, 2003.

The Company has net deferred tax assets aggregating \$24.3 million as of September 30, 2003, as determined in accordance with SFAS 109. Management believes that the Company's deferred tax assets will be realized through the reversal of existing temporary differences between the financial statement and tax basis, as well as through future taxable income.

#### ***Critical Accounting Policies and Estimates***

The Company's accounting policies are more fully described in Note 2, Summary of Significant Accounting Policies, of Notes To Consolidated Financial Statements. As disclosed in Note 2, the preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results may differ from those estimates, and such differences may be material to the consolidated financial statements.

The most significant accounting estimates inherent in the preparation of the Company's consolidated financial statements include estimates associated with its evaluation of the recoverability of goodwill as well as those used in the determination of liabilities related to insurance programs, litigation, and taxation. In addition, significant estimates form the basis for the Company's reserves with respect to sales and returns allowances, collectibility of accounts receivable, inventory valuations, deferred tax assets, and certain benefits provided to current employees. Various assumptions and other factors underlie the determination of these significant estimates. The process of determining significant estimates is fact specific and takes into account factors such as historical experience, current and expected economic conditions and product mix. The Company constantly re-evaluates these significant factors and makes adjustments where facts and circumstances dictate. Specific factors are as follows: recoverability of goodwill and intangible assets are subject to annual impairment testing; litigation is based on projections provided by legal counsel; realization of certain deferred tax assets are based on the Company's projections of future taxable income; sales and returns and allowances are based on historical activity and customer contracts; accounts receivable reserves are based on doubtful accounts and aging of outstanding balances; inventory reserves are based on expected obsolescence and excess inventory levels; and employee benefits are based on benefit plan requirements and severance agreements. Historically, actual results have not significantly deviated from those determined using the estimates described above.

**Revenue Recognition:**

Revenue from sales of products is recorded upon the passing of title and risks of ownership to the customer, which occurs upon the shipment of goods.

The Company offers a variety of sales incentives to its customers primarily in the form of discounts and rebates. Discounts are recognized in the financial statements at the date of the related sale. Rebates are estimated based on the anticipated rebate to be paid and a portion of the estimated cost of the rebate is allocated to each underlying sales transaction. Rebates and discounts are included in the determination of net sales.

The Company also establishes reserves for customer returns and allowances. The reserve is established based on historical rates of returns and allowances. The reserve is adjusted quarterly based on actual experience.

**Inventory Realization:**

Inventories consisting predominantly of finished goods are valued at the lower of cost or market, cost being determined principally on the first-in, first-out method. Excess and obsolete inventories are carried at net realizable value. The historical usage rate is the primary factor used by the Company in assessing the net realizable value of excess and obsolete inventory. A reduction in the carrying value of an inventory item from cost to market is recorded for inventory with no usage in the preceding twelve month period or with on hand quantities in excess of twenty-four months average usage.

**Property and Equipment:**

Property and equipment, including assets acquired under capital leases, are carried at cost and include expenditures for new facilities and major renewals. Maintenance and repairs are charged to expense as incurred. When assets are sold or otherwise disposed of, the cost and related accumulated depreciation are removed from their respective accounts, and the resulting gain or loss is reflected in current operations.

**Depreciation:**

For financial accounting purposes, depreciation, including that related to plant and equipment acquired under capital leases, is computed on the straight-line method over the estimated useful lives of the assets, generally three to ten years, or, if shorter, over the terms of the related leases.

**Goodwill and Other Intangible Assets:**

Prior to January 1, 2002, the Company recorded goodwill related to the excess of acquisition cost over the fair value of net assets acquired and amortized the goodwill on a straight-line basis over twenty-five to forty years. The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" and accordingly, goodwill is no longer amortized, but is reviewed periodically for impairment. Other intangible assets arising principally from acquisitions are amortized on a straight-line basis over periods ranging from three to twenty-five years.

**Long-Lived Assets:**

Under the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", the Company has evaluated its long-lived assets for financial impairment and will continue to evaluate them based on the estimated undiscounted future cash flows as events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable.

**Income Taxes:**

Deferred income taxes are computed using the asset and liability method. Under this method, deferred income tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities (temporary differences) and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Valuation allowances are provided for tax benefits where it is more likely than not that certain future tax benefits will not be realized. Adjustments to valuation allowances are recorded from changes in utilization of the tax related item.

**Self-insurance Reserves:**

The Company purchases third party insurance for worker's compensation, automobile, product and general liability claims that exceed a certain level. However, the Company is responsible for the payment of claims under these insured limits. In estimating the obligation associated with incurred losses, the Company utilizes loss development factors prepared by consulting insurance carriers. These development factors utilize historical data to project the future development of incurred losses. Loss estimates are adjusted based upon actual claims settlements and reported claims.

The Company also purchases third party insurance for group medical claims that exceed a certain level on an individual claim basis and in the aggregate for a plan year. The Company is responsible for the payment of claims under the specific and aggregate insured limits. Reserves for the incurred, but not reported losses are estimated based on several factors including historical claims experience and claims payment lag time information.

**Retirement Benefits:**

Certain employees of the Company are covered under a profit-sharing and retirement savings plan (the "plan"). The plan provides for a matching contribution for eligible employees of 50% of each dollar contributed by the employee up to 6% of employee's compensation. In addition, the plan provides an annual contribution in amounts authorized by the Board, subject to the terms and conditions of the plan.

**Shipping and Handling**

The costs incurred to ship product to customers, including freight and handling expenses, are included in selling, general and administrative ("SG&A") expenses on the Company's Statements of Operations. For the three months ended September 30, 2003 and 2002, shipping and handling costs included in SG&A were \$4,044 and \$3,704, respectively. For the nine months ended September 30, 2003 and 2002, shipping and handling costs included in SG&A were \$11,906 and \$10,380, respectively.

**Research and Development:**

The Company incurs research and development costs in connection with improvements to the key duplicating and engraving machines. For the three months ended September 30, 2003 and 2002, research and development expenses, consisting primarily of internal wages and benefits, were \$424 and \$413, respectively. For the nine months ended September 30, 2003 and 2002, research and development expenses were \$1,148 and \$1,166, respectively.

**Fair Value of Financial Instruments:**

Cash, accounts receivable, short-term borrowings, accounts payable, accrued liabilities and bank revolving credit are reflected in the consolidated financial statements at fair value due to short-term maturity or revolving nature of these instruments.

**Translation of Foreign Currencies:**

The translation of the Company's Canadian foreign currency based financial statements into U.S. dollars is performed for balance sheet accounts using exchange rates in effect at the balance sheet date and for revenue and expense accounts using an average exchange rate during the period.

**Comprehensive Income:**

The components of comprehensive income (loss) for the three and nine month periods ended September 30, 2003 and 2002 were as follows:

	Three Months Ended September 30		Nine Months Ended September 30	
	2003	2002	2003	2002
Net income (loss)	<u>(Restated)</u> \$ 1,720	\$ 2,789	<u>(Restated)</u> \$ (2,547)	\$ 4,627
Foreign currency translation adjustment	<u>1</u>	<u>7</u>	<u>(99)</u>	<u>3</u>
Comprehensive income (loss)	<u>\$ 1,721</u>	<u>\$ 2,796</u>	<u>\$ (2,646)</u>	<u>\$ 4,630</u>

**Use of Estimates in the Preparation of Financial Statements:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Please reference Note 2, Summary of Significant Accounting Policies, of Notes To Consolidated Financial Statements for additional related information.

**Reclassifications:**

Certain amounts in our 2002 consolidated financial statements have been reclassified to conform to the 2003 presentation.

**Inflation**

Inflation in recent years has had a modest impact on the operations of the Company. Continued inflation, over a period of years at higher than current rates, would result in significant increases in inventory costs and operating expenses. However, such higher cost of sales and operating expenses can generally be offset by increases in selling prices, although the ability of the Company's operating divisions to raise prices is dependent on competitive market conditions.

**Forward Looking Statements**

Certain disclosures related to acquisitions, refinancing, capital expenditures, resolution of pending litigation and realization of deferred tax assets contained in this report involve risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We have based these forward-looking statements on our current expectations, assumptions and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions that may cause our actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance, or achievements expressed or implied by such forward-looking statements. Actual results could differ materially from those currently anticipated as a result of a number of factors, including the risks and uncertainties discussed under captions "Risk Factors" set forth in Item 1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements.

In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “could,” “would,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “continue,” “project” or the negative of such terms or other similar expressions. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements included in this Report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Report might not occur.

**Item 3.**

***Quantitative and Qualitative Disclosures About Market Risk***

The Company is exposed to the impact of interest rate changes as borrowings under the senior credit facility bear interest at variable interest rates. It is Hillman's policy to enter into interest rate transactions only to the extent considered necessary to meet objectives. On March 31, 2002, the Company entered into an interest rate cap agreement on a notional amount of \$26.6 million of senior term debt. The interest rate cap agreement, which expires September 30, 2004, caps the LIBOR interest rate at 6% plus the senior credit facility LIBOR margin of between 3.25% and 3.75%. Based on Hillman's exposure to variable rate borrowings at September 30, 2003, a one percent (1%) change in the weighted average interest rate would change the annual interest expense by approximately \$1.0 million.

The Company is exposed to foreign exchange rate changes of the Canadian currency as it impacts the \$0.8 million net asset value of its Canadian subsidiary, The Hillman Group Canada, Ltd., as of September 30, 2003. Management considers the Company's exposure to foreign currency translation gains or losses to be minimal.

**Item 4.**

***Controls and Procedures***

(a) As of the end of the period covered by this quarterly report on Form 10-Q, the Company's chief executive officer and chief financial officer conducted an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15 and 15d-15 of the Securities Exchange Act of 1934). Based upon this evaluation, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them of any material information relating to the Company that is required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934.

(b) There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2003, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**PART II  
OTHER INFORMATION**

**Items 1, 2, 3, 4 & 5 - None**

**Item 6 - Exhibits and Reports on Form 8-K**

**a) Exhibits, Including Those Incorporated by Reference.**

- 31.1 \* Certification of chief executive officer pursuant to rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934.
- 31.2 \* Certification of chief financial officer pursuant to rule 13a-14(a) or 15d-14(a) under Securities Exchange Act of 1934.
- 32.1 + Certification of chief executive officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 + Certification of chief financial officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

- \* Filed herewith.
- + Submitted herewith.

**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.

THE HILLMAN COMPANIES, INC.

*/s/ James P. Waters*

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James P. Waters  
Vice President - Finance  
(Chief Financial Officer)

*/s/ Harold J. Wilder*

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Harold J. Wilder  
Controller  
(Chief Accounting Officer)

DATE: March 26, 2004



**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Max W. Hillman, Chief Executive Officer, certify that:

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

Date: 3/26/04

/s/ Max W. Hillman

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Max W. Hillman  
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, James P. Waters, Chief Financial Officer, certify that:

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

Date: 3/26/04

/s/ James P. Waters

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James P. Waters  
Chief Financial Officer

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

In connection with the Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2003, (the "Report") of The Hillman Companies, Inc. (the "Registrant"), as filed with the Securities and Exchange Commission on the date hereof; I, Max W. Hillman, the Chief Executive Officer of the Registrant, certify, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial conditions and results of operations of the Registrant.

/s/ Max W. Hillman

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Name: Max W. Hillman

Date: March 26, 2004

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

In connection with the Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2003, (the "Report") of The Hillman Companies, Inc. (the "Registrant"), as filed with the Securities and Exchange Commission on the date hereof; I, James P. Waters, the Chief Financial Officer of the Registrant, certify, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial conditions and results of operations of the Registrant.

/s/ James P. Waters

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Name: James P. Waters

Date: March 26, 2004