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

# FORM 10-Q

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

**For the quarterly period ended June 30, 2006**

**Commission file number 1-13293**

# The Hillman Companies, Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **23-2874736** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **10590 Hamilton Avenue Cincinnati, Ohio** | **45231** |
| (Address of principal executive offices) | (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 | None |
| Preferred Securities Guaranty | 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☑

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). YES ☐ NO ☑

On August 11, 2006, there were 6,212.9 Class A Common Shares issued and outstanding, 1,000.0 Class B Common Shares issued and outstanding, 2,787.1 Class C Common Shares issued and outstanding, 82,104.8 Class A Preferred Shares issued and outstanding by the Registrant and 57,282.4 Class A Preferred Shares issued and outstanding by the Hillman Investment Company 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.

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**Item 1.**

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

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 2,196 | $ 26,491 |
| Restricted investments | 408 | 167 |
| Accounts receivable, net | 58,197 | 41,483 |
| Inventories, net | 83,231 | 77,178 |
| Deferred income taxes | 5,399 | 5,659 |
| Other current assets | 2,530 | 2,848 |
| Total current assets | 151,961 | 153,826 |
| Property and equipment, net | 60,563 | 60,717 |
| Goodwill | 261,267 | 241,461 |
| Other intangibles, net | 171,118 | 160,507 |
| Restricted investments | 4,551 | 4,642 |
| Deferred financing fees, net | 5,174 | 5,712 |
| Investment in trust common securities | 3,261 | 3,261 |
| Other assets | 743 | 1,210 |
| Total assets | $ 658,638 | $ 631,336 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 28,167 | $ 17,625 |
| Current portion of senior term loans | 2,175 | 2,175 |
| Current portion of capitalized lease obligations | 122 | 44 |
| Accrued expenses: | | |
| Salaries and wages | 2,924 | 3,378 |
| Pricing allowances | 5,856 | 9,603 |
| Income and other taxes | 2,028 | 1,739 |
| Interest | 4,413 | 4,203 |
| Deferred compensation | 408 | 167 |
| Other accrued expenses | 8,626 | 10,464 |
| Total current liabilities | 54,719 | 49,398 |
| Long term senior term loans | 231,664 | 212,062 |
| Long term capitalized lease obligations | 299 | 55 |
| Long term unsecured subordinated notes | 49,727 | 49,172 |
| Junior subordinated debentures | 117,098 | 117,295 |
| Mandatorily redeemable preferred stock (Note 9) | 73,708 | 69,695 |
| Management purchased options (Note 9) | 4,362 | 4,087 |
| Deferred compensation | 4,551 | 4,642 |
| Deferred income taxes | 36,762 | 36,026 |
| Accrued dividends on preferred stock | 23,851 | 18,057 |
| Other non-current liabilities | 4,072 | 3,156 |
| Total liabilities | 600,813 | 563,645 |

**Item 1.**

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

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| LIABILITIES AND STOCKHOLDERS' EQUITY (CONTINUED) | | |
| Common stock with put options: | | |
| Class A Common stock, $.01 par, 23,141 shares authorized, 407.6 issued and outstanding | 407 | 407 |
| Class B Common stock, $.01 par, 2,500 shares authorized, 1,000 issued and outstanding | 735 | 1,311 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Preferred Stock: | | |
| Class A Preferred stock, $.01 par, 238,889 shares authorized, 82,104.8 issued and outstanding | 1 | 1 |
| Common Stock: | | |
| Class A Common stock, $.01 par, 23,141 shares authorized, 5,805.3 issued and outstanding | — | — |
| Class C Common stock, $.01 par, 30,109 shares authorized, 2,787.1 issued and outstanding | — | — |
| Additional paid-in capital | 63,812 | 69,594 |
| Accumulated deficit | (6,970) | (3,654) |
| Accumulated other comprehensive (loss) income | (160) | 32 |
| Total stockholders' equity | 56,683 | 65,973 |
| Total liabilities and stockholders' equity | $ 658,638 | $ 631,336 |

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**
**FOR THE THREE MONTHS ENDED**

**(dollars in thousands)**

| | June 30, 2006 | June 30, 2005 |
|---|---|---|
| Net sales | $ 113,358 | $ 102,934 |
| Cost of sales (exclusive of depreciation and amortization shown separately below) | 54,557 | 46,578 |
| Gross profit | 58,801 | 56,356 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 38,417 | 36,399 |
| Depreciation | 4,105 | 3,865 |
| Amortization | 1,936 | 1,808 |
| Management and transaction fees to related party | 252 | 278 |
| Total operating expenses | 44,710 | 42,350 |
| Other income (expense), net | 42 | (38) |
| Income from operations | 14,133 | 13,968 |
| Interest expense, net | 6,423 | 5,228 |
| Interest expense on mandatorily redeemable preferred stock and management purchased options | 2,185 | 1,959 |
| Interest expense on junior subordinated debentures | 3,152 | 3,153 |
| Investment income on trust common securities | (94) | (95) |
| Income before income taxes | 2,467 | 3,723 |
| Income tax provision | 1,913 | 3,762 |
| Net income (loss) | $ 554 | $ (39) |

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**
**FOR THE SIX MONTHS ENDED**

**(dollars in thousands)**

| | June 30, 2006 | June 30, 2005 |
|---|---|---|
| Net sales | $ 214,883 | $ 190,534 |
| Cost of sales (exclusive of depreciation and amortization shown separately below) | 104,933 | 85,679 |
| Gross profit | 109,950 | 104,855 |
| Operating expenses: | | |
| Selling, general and administrative expenses | 76,526 | 71,119 |
| Depreciation | 8,189 | 7,887 |
| Amortization | 3,873 | 3,612 |
| Management and transaction fees to related party | 508 | 533 |
| Total operating expenses | 89,096 | 83,151 |
| Other income (expense), net | 319 | (187) |
| Income from operations | 21,173 | 21,517 |
| Interest expense, net | 12,658 | 9,904 |
| Interest expense on mandatorily redeemable preferred stock and management purchased options | 4,288 | 3,845 |
| Interest expense on junior subordinated debentures | 6,304 | 6,305 |
| Investment income on trust common securities | (189) | (189) |
| (Loss) income before income taxes | (1,888) | 1,652 |
| Income tax provision | 1,428 | 2,015 |
| Net loss | $ (3,316) | $ (363) |

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**
**FOR THE SIX MONTHS ENDED**

**(dollars in thousands)**

| | June 30, 2006 | June 30, 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net loss | $ (3,316) | $ (363) |
| Adjustments to reconcile net loss to net cash used for operating activities: | | |
| Depreciation and amortization | 12,062 | 11,499 |
| Deferred income tax provision | 997 | 2,063 |
| PIK interest on unsecured subordinated notes | 555 | 548 |
| Interest on mandatorily redeemable preferred stock and management purchased options | 4,289 | 3,845 |
| Net realized gain on sale of securities | (71) | — |
| Changes in operating items: | | |
| Increase in accounts receivable, net | (16,714) | (15,056) |
| Increase in inventories, net | (6,053) | (17,809) |
| Decrease (increase) in other assets | 694 | (547) |
| Increase in accounts payable | 10,542 | 2,862 |
| Decrease in other accrued liabilities | (5,541) | (4,060) |
| Other items, net | 614 | 535 |
| Net cash used for operating activities | (1,942) | (16,483) |
| Cash flows from investing activities: | | |
| SteelWorks acquisition | (34,241) | — |
| Capital expenditures | (7,686) | (8,305) |
| Other, net | 33 | (92) |
| Net cash used for investing activities | (41,894) | (8,397) |
| Cash flows from financing activities: | | |
| Repayments of senior term loans | (1,631) | (1,087) |
| Borrowings of revolving credit loans | 21,233 | — |
| Principal payments under capitalized lease obligations | (61) | (22) |
| Net cash provided by (used for) financing activities | 19,541 | (1,109) |
| Net decrease in cash and cash equivalents | (24,295) | (25,989) |
| Cash and cash equivalents at beginning of period | 26,491 | 29,613 |
| Cash and cash equivalents at end of period | $ 2,196 | $ 3,624 |

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THE HILLMAN COMPANIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)
(dollars in thousands)

| | Common Stock Class A | Common Stock Class C | Additional Paid-in Capital | Class A Preferred Stock | Accumulated Deficit | Comprehensive Income(Loss) | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|
| Balance at December 31, 2005 | — | — | $ 69,594 | $ 1 | $ (3,654) | | $ 32 | $ 65,973 |
| Dividends to shareholders | — | — | (5,794) | — | — | | — | (5,794) |
| Stock-based compensation | | | 12 | | | | | 12 |
| Comprehensive income (loss): | | | | | | | | |
| Net loss | — | — | — | — | (3,316) | $ (3,316) | — | (3,316) |
| Other comprehensive income (loss), net of tax: | | | | | | | | |
| Net realized gain on investment (2) | — | — | — | — | — | (75) | (75) | (75) |
| Change in cumulative foreign translation adjustment (1) | — | — | — | — | — | (26) | (26) | (26) |
| Change in derivative security value (1) | — | — | — | — | — | (91) | (91) | (91) |
| Other comprehensive loss | | | | | | (192) | | |
| Comprehensive loss | | | | | | $ (3,508) | | |
| Balance at June 30, 2006 | — | — | $ 63,812 | $ 1 | $ (6,970) | | $ (160) | $ 56,683 |

(1) The cumulative foreign translation adjustment and change in derivative security value, net of taxes, represent the only items of other comprehensive income.

(2) Reclassification to net loss of previously unrealized gains.

SEE ACCOMPANYING NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**1. Basis of Presentation:**

The accompanying financial statements include the condensed consolidated accounts of The Hillman Companies, Inc. ("Hillman" or the "Company") and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

An affiliate of Code Hennessy & Simmons LLC ("CHS") owns 49.1% of the Company's outstanding common stock and 54.5% of the Company's voting common stock, Ontario Teacher's Pension Plan ("OTPP") owns 27.9% of the Company's outstanding common stock and 31.0% of the Company's voting common stock and HarbourVest Partners VI owns 8.7% of the Company's outstanding common stock and 9.7% of the Company's voting common stock. OTPP's voting rights with respect to the election of directors to the Board of Directors is limited to the lesser of 30.0% or the actual percentage of voting stock held. Certain members of management own 14.1% of the Company's outstanding common stock and 4.5% of the Company's voting common stock.

The accompanying unaudited condensed 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 six and three months ended June 30, 2006 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, 2005.

**Nature of Operations:**

The Company is one of the largest providers of hardware-related products and related merchandising services to retail markets in North America. The Company's principal business is operated through its wholly-owned subsidiary, The Hillman Group, Inc. (the "Hillman Group") which sells its product lines and provides its services to hardware stores, home centers, mass merchants, pet supply stores, and other retail outlets principally in the United States, Canada, Mexico and South America. Product lines include thousands of small parts such as fasteners and related hardware items; keys, key duplication systems and accessories; and identification items, such as tags and letters, numbers, and signs. The Company supports its product sales with value-added services, including design and installation of merchandising systems and maintenance of appropriate in-store inventory levels.

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

**Accounts Receivable and Allowance for Doubtful Accounts**:

The Company establishes the allowance for doubtful accounts using the specific identification method and also provides a reserve in the aggregate. The estimates for calculating the aggregate reserve are based on historical information. The allowance for doubtful accounts was $501 and $434 as of June 30, 2006 and December 31, 2005, respectively.

**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 six months and three months ended June 30, 2006 and 2005 shipping and handling costs included in SG&A were $10,976, $9,063, $5,880 and $4,971, respectively.

(dollars in thousands)

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

**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.

**Reclassifications:**

Certain amounts in the 2005 condensed consolidated financial statements have been reclassified to conform to the 2006 presentation.

**3. Recent Accounting Pronouncements:**

In July 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109." FIN 48 clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt this interpretation as required. The Company is currently evaluating the impact of this Interpretation on its financial statements.

**4. Acquisition:**

On January 5, 2006, the Company's Hillman Group, Inc. subsidiary purchased certain assets of The SteelWorks Corporation ("SteelWorks"), a Denver, Colorado based manufacturer and distributor of metal shapes, threaded rod and metal sheet to the retail hardware and home improvement industry. The aggregate purchase price, including transaction costs of $123, was $34,364 paid in cash at closing. The accompanying condensed consolidated balance sheet at June 30, 2006 reflects the preliminary allocation of the aggregate purchase price in accordance with SFAS No. 141, "Business Combinations." The following table reconciles the fair value of the acquired assets and assumed liabilities to the total purchase price:

| | |
|---|---|
| Customer relationships | $ 11,861 |
| Trademarks | 2,624 |
| Goodwill | 19,879 |
| Total purchase price | $ 34,364 |

The preliminary values assigned to customer relationships and trademarks were determined by an independent appraisal. The customer relationships have been assigned a 23 year life and the trademarks an indefinite life. The intangible assets and goodwill are deductible for income tax purposes over a 15 year life.

(dollars in thousands)

**4. Acquisition (continued):**

The following table indicates the pro forma financial statements of the Company for the six and three months ended June 30, 2005 had the acquisition of SteelWorks been consummated on January 1, 2005. The pro forma financial statement impact for the six months ended June 30, 2006 is not material.

| | Six Months | Three Months |
|---|---|---|
| Net sales | $ 204,664 | $ 110,292 |
| Net income | $ 616 | $ 487 |

In connection with the acquisition, the Hillman Group, Inc. entered into a supply agreement whereby SteelWorks will be their exclusive provider of metal shapes for a period of 10 years.

**5. Goodwill and Other Intangible Assets:**

The Company follows SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 provides for the non-amortization of goodwill. Goodwill is subject to at least an annual assessment for impairment by applying a fair value-based test. Other intangible assets are amortized over their useful lives and are subject to impairment testing.

Intangible assets as of June 30, 2006 and December 31, 2005 consist of the following:

| | Estimated Useful Life (Years) | June 30, 2006 | December 31, 2005 |
|---|---|---|---|
| Customer relationships | 23 | $ 126,651 | $ 114,790 |
| Trademarks | Indefinite | 47,294 | 44,670 |
| Patents | 9 | 7,960 | 7,960 |
| Non-compete agreements | 4 | 5,742 | 5,742 |
| Intangible assets, gross | | 187,647 | 173,162 |
| Less: Accumulated amortization | | 16,529 | 12,655 |
| Other intangibles, net | | $ 171,118 | $ 160,507 |

The Company's amortization expense for amortizable assets for the three months ended June 30, 2006 and 2005 was $1,936 and $1,808, respectively. For the six months ended June 30, 2006 and 2005 amortization expense was $3,873 and $3,612, respectively. The Company's amortization expense for amortizable assets for the year ended December 31, 2006 is estimated to be $7,747 and for the years ending December 31, 2007, 2008, 2009, 2010, and 2011 are estimated to be $7,273, $7,037, $6,875, $6,391, and $6,391, respectively.

**6. 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 June 30, 2006, the Company has provided insurers letters of credit aggregating $5,643 related to certain insurance programs.

**6. Contingencies (continued):**

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 condensed consolidated financial position, operations or cash flows of the Company.

**7. Related Party Transactions:**

The Company is obligated to pay management fees to a subsidiary of CHS in the amount of $58 per month and to pay transaction fees to a subsidiary of OTPP in the amount of $26 per month, plus out of pocket expenses. The Company has recorded management and transaction fee charges and expenses from CHS and OTPP for the six and three month periods ended June 30, 2006 and 2005 of $508, $533, $252 and $278, respectively.

**8. Income Taxes:**

The Company's policy is to estimate income taxes for interim periods based on estimated annual effective tax rates which are derived, in part, from expected pre-tax income. However, the income tax provision for the six and three months ended June 30, 2006 has been computed on a discrete period basis as a result of the Company's inability to reliably estimate pre-tax income for the remainder of the year. The Company's estimated annual effective tax rate for the year ended December 31, 2006 is -4811%, which could result in significant variations in the reported tax provision in the interim periods. Accordingly, the interim tax provision for the six and three month periods ended June 30, 2006 was calculated on a discrete period basis by multiplying the statutory income tax rate by pretax earnings adjusted for permanent book tax basis differences.

The effective income tax rate was -75.6% and 122.0% for the six months ended June 30, 2006 and 2005, respectively. The effective income tax rate differed from the federal statutory rate in both periods primarily as a result of nondeductible interest on mandatorily redeemable preferred stock and stock compensation expense.

**9. Common and Preferred Stock:**

Common Stock:

There are 23,141 authorized shares of Class A Common Stock, 6,212.9 of which are issued and outstanding. Each share of Class A Common Stock entitles its holder to one vote. Each holder of Class A Common Stock is entitled at any time to convert any or all of the shares into an equal number of shares of Class C Common Stock.

There are 2,500 authorized shares of Class B Common Stock, 1,000 of which are issued and outstanding. Holders of Class B Common Stock have no voting rights. The Class B Common Stock was purchased by and issued to certain members of the Company's management and is subject to vesting over five years with 20% vesting on each anniversary of the March 31, 2004 issuance.

In connection with the March 31, 2004 acquisition of the Company by an affiliate of CHS ("Merger Transaction"), certain members of management entered into an Executive Securities Agreement ("ESA"). The ESA provides for the method and terms under which management proceeds were invested in the Company. Under the terms of the ESA, management shareholders have the right to put their Class A Common Stock and Class B Common Stock back to the Company at fair market value if employment is terminated for other than cause. If terminated for cause, the management shareholders can generally put the Class A Common Stock and Class B Common Stock back to the Company for the lower

**9. Common and Preferred Stock (continued):**

of the fair market value or cost. The SEC's Accounting Series Release No. 268, "Presentation in Financial Statements of Redeemable Preferred Stock," requires certain securities whose redemption is not in the control of the issuer to be classified outside of permanent equity. The put feature embedded in management's Class A Common Stock and Class B Common Stock allows redemption at the holder's option under certain circumstances. Accordingly, management's 407.6 Class A Common Stock shares and 1,000 Class B Common Stock shares have been classified between liabilities and stockholder's equity in the accompanying condensed consolidated balance sheet.

There are 30,109 authorized shares of Class C Common Stock, 2,787.1 of which are issued and outstanding. Each share of Class C Common Stock entitles its holder to one vote, provided that the aggregate voting power of Class C Common Stock (with respect to the election of directors) never exceeds 30%. Each holder of Class C Common Stock is entitled at any time to convert any or all of the shares into an equal number of shares of Class A Common Stock.

Preferred Stock:

The Company has 238,889 authorized shares of Class A Preferred Stock, 82,104.8 of which are issued and outstanding and 13,450.7 of which are reserved for issuance upon the exercise of options to purchase shares of Class A Preferred Stock. Holders of Class A Preferred Stock are not entitled to any voting rights. Holders of Class A Preferred Stock are entitled to preferential dividends that shall accrue on a daily basis at the rate of 11.5% per annum of the sum of the Liquidation Value (as defined in the Certificate of Incorporation) thereof plus all accumulated and unpaid dividends thereon.

Hillman Investment Company, a subsidiary of the Company, has 166,667 authorized shares of Class A Preferred Stock, 57,282.4 of which are issued and outstanding and 9,384.2 of which are reserved for issuance upon the exercise of options to purchase shares of Class A Preferred Stock. Holders of Class A Preferred Stock are not entitled to any voting rights. Holders of Class A Preferred Stock are entitled to preferential dividends that shall accrue on a daily basis at the rate of 11.0% per annum on the sum of the Liquidation Value (as defined in the Certificate of Incorporation) thereof plus all accumulated and unpaid dividends thereon.

The Hillman Investment Company Class A Preferred Stock is mandatorily redeemable on March 31, 2028 and in accordance with Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity," ("SFAS 150") has been classified as debt in the accompanying condensed consolidated balance sheets. Dividends on the mandatorily redeemable Class A Preferred Stock are included in interest expense on the accompanying condensed consolidated statements of operations. For the six and three months ended June 30, 2006 and 2005, interest expense of $4,013, $3,600, $2,044 and $1,834, respectively, was recorded in the accompanying statement of operations.

Purchased Options:

In connection with the Merger Transaction, options in the predecessor to the Company were cancelled and converted into rights to receive options to purchase 3,895.16 shares of Hillman Companies, Inc. Class A Preferred Stock and 2,717.55 shares of Hillman Investment Company Class A Preferred Stock (collectively the "Purchased Options"). The Purchased Options have a weighted average strike price of $170.69 per share. The fair value of the Hillman Investment Company Class A Preferred Stock options has been included with the underlying security in the accompanying condensed consolidated balance sheets. SFAS 150 requires security instruments with a redemption date that is certain to occur to be classified as liabilities. The Hillman Companies, Inc. Class A Preferred Stock options, which have a March 31, 2028 expiration date, have been classified at their fair market value in the liability section of the accompanying condensed consolidated balance sheets. To the extent the Company pays a dividend to

**9. Common and Preferred Stock (continued):**

holders of the Class A Preferred Stock and the Hillman Investment Company Class A Preferred Stock, the Purchased Option holder will be entitled to receive an amount equal to the dividend which would have been paid if the Purchased Options had been exercised on the date immediately prior to the record date for the dividend. Dividends on the Purchased Options are recorded as interest expense in the accompanying condensed consolidated statement of operations. Additionally, under the terms of the ESA, the Purchased Options can be put back to the Company at fair market value if employment is terminated.

SFAS 150 requires the initial and subsequent valuations of the Purchased Options be measured at fair value with the change in fair value recognized as interest expense. For the six and three months ended June 30, 2006 and 2005, interest expense of $275, $245, $141 and $125, respectively, was recorded in the accompanying statement of operations to recognize the increase in fair market value of the Purchased Options.

**10. Stock-Based Compensation:**

Effective January 1, 2006, the company adopted SFAS No. 123(R) using the modified prospective method. SFAS No. 123(R) requires entities to recognize the cost of employee services in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). That cost, based on the estimated number of awards that are expected to vest, will be recognized over the period during which the employee is required to provide the service in exchange for the award. No compensation cost is recognized for awards for which employees do not render the requisite service.

Compensation cost for the unvested portions of equity-classified awards granted prior to January 1, 2006, will be recognized in the results of operations on a straight line basis over the remaining vesting periods. Changes in fair value of unvested liability instruments during the requisite service period will be recognized as compensation cost over that service period. Changes in the fair value of vested liability instruments during the contractual term will be recognized as an adjustment to compensation cost in the period of the change in fair value.

Due to the prospective adoption of SFAS No. 123(R), results for prior periods have not been restated.

Common Option Plan:

On March 31, 2004, the Company adopted the 2004 Stock Option Plan (“Common Option Plan”) following Board and shareholder approval. Grants under the Common Option Plan will consist of non-qualified stock options for the purchase of Class B Common Shares. The number of Class B Common Shares authorized for issuance under the Common Option Plan is not to exceed 356.41 shares. Unless otherwise consented to by the Board, the aggregate number of Class B Common Shares for which options may be granted under the Common Option Plan cannot exceed 71.28 in any one calendar year. The Common Option Plan is administered by a Committee of the Board. The Committee determines the term of each option, provided that the exercise period may not exceed ten years from date of grant.

The fair value of the option grants is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions: dividend yield equaling 0%, risk-free interest rate of 4.7%, expected volatility assumed to be 26.8%, and expected life of 6 years.

A summary of stock option activity for the six months ended June 30, 2006 is presented below:

(dollars in thousands)

**10. Stock-Based Compensation (continued):**

| | Shares | Exercise Price Per Share * | Remaining Contractual Term * | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Outstanding at December 31, 2005 | 61.3 | $ 1,523 | | |
| Granted | 51.3 | $ 2,275 | | |
| Exercised | — | — | | |
| Forfeited or expired | — | — | | |
| Outstanding at June 30, 2006 | 112.6 | $ 1,866 | 8.76 years | $ 46 |
| Exercisable at June 30, 2006 | 10.0 | $ 1,000 | 7.96 years | $ 13 |

* weighted average

Compensation expense of $12 and $8 has been recognized in the accompanying condensed consolidated statements of operations for the six and three months ended June 30, 2006, respectively. As of June 30, 2006, there was $59 of unrecognized compensation expense for unvested Common Options. The expense will be recognized as a charge to earnings over a weighted average period of 1.1 years.

In the six months ended June 30, 2005, the Company did not recognize any stock-based compensation expense on the Common Options in accordance with APB Opinion 25. For the six months ended June 30, 2005, compensation expense determined consistent with SFAS 123(R) would not have been material.

Preferred Options:

On March 31, 2004, certain members of the Company's management were granted options to purchase 9,555.5 shares of Class A Preferred Stock and 6,666.7 shares of Hillman Investment Company Class A Preferred Stock (collectively the "Preferred Options"). The Preferred Options were granted with an exercise price of $1,000 per share which was equal to the value of the underlying Preferred Stock. The Preferred Options vest over five years with 20% vesting on each anniversary of the Merger Transaction. Holders of the Preferred Options are entitled to accrued dividends as if the underlying Preferred Stock were issued and outstanding as of the grant date. There have been no grants, forfeitures or exercise of the Preferred Options since March 31, 2004.

Upon resignation from the Company after the third anniversary of grant, termination by the Company without cause, death or disability, or retirement at age 61, the holder of the Preferred Options has a put right on the vested securities at a price equal to fair market value less any option exercise price payable. FIN 44 requires variable accounting treatment for stock awards with employee repurchase rights. Under APB Opinion No. 25, compensation expense was recognized to the extent the market value of the underlying security on the measurement date exceeds the cost to the employee. The market value on the Preferred Options increased by the amount of dividends accrued on the underlying Preferred Stock. Compensation expense was recognized over the five-year vesting period in accordance with FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans – an interpretation of APB Opinions No. 15 and 25 ("FIN 28").

SFAS 123(R) requires the classification of stock-based compensation awards as liabilities if the underlying security is classified as a liability. Therefore, the Preferred Options are treated as liability classified awards, and compensation expense is recognized based on the fair value of the Preferred Options at the grant date re-measured at fair value in each subsequent reporting period. The Company uses the intrinsic value method to estimate fair value of the Preferred Options at the end of each reporting period pro-rated for the portion of the service period rendered.

**10. Stock-Based Compensation (continued):**

The intrinsic value method used to determine the value of the Preferred Options under SFAS 123(R) is unchanged from the method used under APB Opinion No. 25. As a result, the January 1, 2006 adoption of SFAS 123(R) does not change the amount of stock-based compensation recognized on the Preferred Options. For the six and three months ended June 30, 2006 and 2005, compensation expense of $1,088, $500, $585 and $285, respectively, was recognized in the accompanying condensed consolidated statements of operations.

At June 30, 2006, the aggregate intrinsic value of the outstanding Preferred Options was $4,619, and the intrinsic value of the exercisable Preferred Options was $1,847.

Class B Shares:

The repurchase and vesting features of the Class B Common Stock triggered variable accounting treatment under FASB Interpretation No. 44, Accounting For Certain Transactions involving Stock Compensation – an interpretation of APB Opinion No. 25 (“FIN 44”). See Note 9, Common and Preferred Stock, for a more detailed description of the Class B Common Stock.

Under SFAS 123(R), the repurchase feature requires classification of the Class B Common Stock as liability awards. The Company uses the intrinsic value method to estimate fair value of the Class B Common Stock Shares at the end of each reporting period pro-rated for the portion of the service period rendered. Again, the valuation and recognition of expense under SFAS 123(R) is consistent with variable accounting treatment of APB Opinion No. 25.

There have been no grants or forfeitures of Class B Common Stock shares since the Merger Transaction. At June 30, 2006, there were 400 Class B Common shares vested with a fair value of $0.5 per share. For the six and three month periods ended June 30, 2006 and 2005, compensation expense (income) of ($576), $232, ($794) and $117, respectively, was recorded in the accompanying condensed consolidated statements of operations.

**11. Derivatives and Hedging:**

The Company uses derivative financial instruments to manage its exposures to interest rate fluctuations on its floating rate senior debt. The derivative instruments are accounted for pursuant to SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended by SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities.” As amended, SFAS No. 133 requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as an effective hedge that offsets certain exposures.

On April 28, 2004, the Company entered into an Interest Rate Swap Agreement (“Swap”) with a two-year term for a notional amount of $50 million. The Swap fixed the interest rate on $50 million of the Senior Term Loan at a rate of 1.17% plus the applicable interest rate margin for the first three months of the Swap with incremental increases ranging from 28 to 47 basis points in each successive quarter.

The Swap was designated as a cash flow hedge and the fair value at March 31, 2006 was $52, net of $34 in tax expense. The Swap was reported on the condensed consolidated balance sheet in other current assets with a related deferred gain recorded as a component of other comprehensive income in shareholders’ equity.

**12. Subsequent Event:**

On March 31, 2004, the Company, through its Hillman Group subsidiary, refinanced its revolving credit and senior term loans with a Senior Credit Agreement (the “Senior Credit Agreement”) consisting of a $40.0 million revolving credit (the “Revolver”) and a $217.5 million term loan (the “Term Loan”). The Senior Credit Agreement has a seven-year term and provides borrowings at interest rates based on the London Interbank Offered Rates (the “LIBOR”) plus a margin of between 2.25% and 3.00% (the “LIBOR Margin”), or prime (the “Base Rate”) plus a margin of between 1.25% and 2.0% (the “Base Rate Margin”).

On July 21, 2006, the Company amended and restated the Senior Credit Agreement. The Term Loan was increased by $22.4 million to $235.0 million. Proceeds of the additional Term Loan borrowings were used to pay down outstanding Revolver borrowings. The Revolver credit remains at $40 million. Additionally, the LIBOR margin on the Term Loan was reduced by 25 basis points and certain financial covenants were revised to provide additional flexibility. There were no other significant changes to the Senior Credit Agreement. The Company incurred $1,049 in financing fees in connection with amended and restated agreement. The fees will be capitalized and amortized over the remaining term of the Senior Credit Agreement, as amended.

On March 31, 2004, the Company, through its Hillman Group subsidiary, issued $47.5 million of unsecured subordinated notes to Allied Capital maturing on September 30, 2011 (“Subordinated Debt Issuance”). Interest on the Subordinated Debt Issuance was at a fixed rate of 13.5% per annum, with cash interest payments required on a quarterly basis at a fixed rate of 11.25% commencing April 15, 2004. The outstanding principal balance of the Subordinated Debt Issuance was increased on a quarterly basis at the remaining 2.25% fixed rate (the “PIK Amount”).

Effective July 21, 2006, the Subordinated Debt Agreement was amended to reduce the interest rate to a fixed rate of 10.0% payable quarterly. In addition, financial covenants were revised consistent with the changes to the amended and restated Senior Credit Agreement. The reduction in the interest rate was retroactive to May 15, 2006.

Emerging Issues Task Force Issue No. 96-19 (“EITF 96-19”) provides guidance on the debtor’s accounting for modifications of a debt instrument. Under EITF 96-19, modifications to a debt instrument deemed to be substantially different require recognition as an extinguishment of debt. An exchange of debt instruments where the present value of cash flows is greater than 10% different from the present value of cash flows under the terms of the original debt instrument would be considered substantially different. The reduction in the interest rate in the amended Subordinated Debt Issuance reduces the present value of cash flows more than 10% and, accordingly, the Company will recognize a loss on the modification of the terms of the Subordinated Debt Issuance of $737 in the third quarter of 2006.

**Item 2.**

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

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 condensed 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 hardware-related products and related merchandising services to retail markets in North America.

The Company's principal business is operated through its wholly-owned subsidiary, The Hillman Group, Inc. (the "Hillman Group") which sells its product lines and provides its services to hardware stores, home centers, mass merchants, pet supply stores, and other retail outlets principally in the United States, Canada, Mexico and South America. Product lines include thousands of small parts such as fasteners and related hardware items; keys, key duplication systems and accessories; and identification items, such as tags and letters, numbers, and signs ("LNS"). The Company supports its product sales with value added services including design and installation of merchandising systems and maintenance of appropriate in-store inventory levels.

An affiliate of Code Hennessy & Simmons LLC ("CHS") owns 49.1% of the Company's outstanding common stock and 54.5% of the Company's voting common stock, Ontario Teacher's Pension Plan ("OTPP") owns 27.9% of the Company's outstanding common stock and 31.0% of the Company's voting common stock and HarbourVest Partners VI owns 8.7% of the Company's outstanding common stock and 9.7% of the Company's voting common stock. OTPP's voting rights with respect to the election of directors to the Board of Directors is limited to the lesser of 30.0% or the actual percentage of voting stock held. Certain members of management own 14.1% of the Company's outstanding common stock and 4.5% of the Company's voting common stock.

### *Financing Arrangements*

On March 31, 2004, the Company, through its Hillman Group subsidiary, refinanced its revolving credit and senior term loans with a Senior Credit Agreement (the "Senior Credit Agreement") consisting of a $40.0 million revolving credit (the "Revolver") and a $217.5 million term loan (the "Term Loan"). The Senior Credit Agreement has a seven-year term and provides borrowings at interest rates based on the London Interbank Offered Rates (the "LIBOR") plus a margin of between 2.25% and 3.00% (the "LIBOR Margin"), or prime (the "Base Rate") plus a margin of between 1.25% and 2.0% (the "Base Rate Margin"). The applicable LIBOR Margin and Base Rate Margin are based on the Company's leverage as of the last day of the preceding fiscal quarter. In accordance with the Senior Credit Agreement, letter of credit commitment fees are based on the average daily face amount of each outstanding letter of credit multiplied by a letter of credit margin of between 2.25% and 3.00% per annum (the "Letter of Credit Margin"). The Letter of Credit Margin is also based on the Company's leverage at the date of the preceding fiscal quarter. The Company also pays a commitment fee of 0.50% per annum on the average daily unused Revolver balance.

On July 21, 2006, the Company amended and restated the Senior Credit Agreement. The Term Loan was increased by $22.4 million to $235.0 million. Proceeds of the additional Term Loan borrowings were used to pay down outstanding Revolver borrowings. The Revolver credit remains at $40 million. Additionally, the LIBOR margin on the Term Loan was reduced by 25 basis points and certain financial covenants were revised to provide additional flexibility. There were no other significant changes to the Senior Credit Agreement. The Company incurred $1,049 in financing fees in connection with amended and restated agreement. The fees will be capitalized and amortized over the remaining term of the Senior Credit Agreement, as amended.

On March 31, 2004, the Company, through its Hillman Group subsidiary, issued $47.5 million of unsecured subordinated notes to Allied Capital maturing on September 30, 2011 (“Subordinated Debt Issuance”). Interest on the Subordinated Debt Issuance is at a fixed rate of 13.5% per annum, with cash interest payments required on a quarterly basis at a fixed rate of 11.25% commencing April 15, 2004. The outstanding principal balance of the Subordinated Debt Issuance shall be increased on a quarterly basis at the remaining 2.25% fixed rate (the “PIK Amount”). All of the PIK Amounts are due on the maturity date of the Subordinated Debt Issuance.

Effective July 21, 2006, the Subordinated Debt Agreement was amended to reduce the interest rate to a fixed rate of 10.0% payable quarterly. In addition, financial covenants were revised consistent with the changes to the amended and restated Senior Credit Agreement. The reduction in the interest rate was retroactive to May 15, 2006.

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.

On April 28, 2004, the Company entered into an Interest Rate Swap Agreement (“Swap”) with a two-year term for a notional amount of $50.0 million. The Swap fixed the interest rate on $50.0 million of the Senior Term Loan at a rate of 1.17% plus the applicable interest rate margin for the first three months of the Swap with incremental increases ranging from 28 to 47 basis points in each successive quarter. The Swap expired on April 28, 2006.

***Acquisition***

On January 5, 2006, the Company’s Hillman Group, Inc. subsidiary purchased certain assets of The SteelWorks Corporation (“SteelWorks”), a Denver, Colorado based manufacturer and distributor of metal shapes, threaded rod and metal sheet to the retail hardware and home improvement industry. Annual revenues of the SteelWorks customer base acquired are approximately $31 million. The aggregate purchase price was $34.3 million paid in cash at closing. In connection with the acquisition, the Hillman Group, Inc. entered into a supply agreement whereby SteelWorks will be their exclusive provider of metal shapes for a period of 10 years.

***Results of Operations***

**Sales and Profitability for each of the Three Month Periods Ended June 30,**

| | (dollars in thousands) | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Amount | % of Total | Amount | % of Total |
| Net sales | $ 113,358 | 100.0% | $ 102,934 | 100.0% |
| Cost of sales (exclusive of depreciation and amortization shown separately below) | 54,557 | 48.1% | 46,578 | 45.3% |
| Gross profit | 58,801 | 51.9% | 56,356 | 54.7% |
| Operating expenses: | | | | |
| Selling | 19,227 | 17.0% | 18,411 | 17.9% |
| Warehouse & delivery | 14,267 | 12.6% | 12,661 | 12.3% |
| General & administrative | 5,124 | 4.5% | 4,926 | 4.8% |
| Stock compensation expense | (201) | -0.2% | 401 | 0.4% |
| Total SG&A | 38,417 | 33.9% | 36,399 | 35.4% |
| Depreciation | 4,105 | 3.6% | 3,865 | 3.8% |
| Amortization | 1,936 | 1.7% | 1,808 | 1.8% |
| Management and transaction fees | 252 | 0.2% | 278 | 0.3% |
| Total operating expenses | 44,710 | 39.4% | 42,350 | 41.1% |
| Other income (expense) | 42 | 0.0% | (38) | 0.0% |
| Income from operations | 14,133 | 12.5% | 13,968 | 13.6% |
| Interest expense, net | 6,423 | 5.7% | 5,228 | 5.1% |
| Interest expense on mandatorily redeemable preferred stock & management purchased options | 2,185 | 1.9% | 1,959 | 1.9% |
| Interest expense on junior subordinated notes | 3,152 | 2.8% | 3,153 | 3.1% |
| Investment income on trust common securities | (94) | -0.1% | (95) | -0.1% |
| Income before income taxes | 2,467 | 2.2% | 3,723 | 3.6% |

**Three Months Ended June 30, 2006 and 2005**

Net sales increased $10.4 million, or 10.1%, in the second quarter of 2006 to $113.4 million from $102.9 million in the second quarter of 2005. Sales of threaded rod products to the newly acquired SteelWorks accounts represented $7.5 million of the $10.4 million increase.

Sales of the remaining Company products, excluding sales to SteelWorks' accounts, were $2.9 million of the total $10.4 million sales increase in the second quarter of 2006. Sales to national accounts represented $1.9 million of the sales increase primarily as a result of increased fastener sales to Lowe's and increased sales of keys to Wal-mart and LNS to Lowe's and Home Depot. Sales of engraving products increased $0.8 million in the second quarter of 2006 and sales of fasteners to WW Grainger in the newly created commercial industrial accounts were $0.4 million in the second quarter of 2006 compared to no sales in the same prior year period. Other sales, including franchise and independent ("F&I") accounts, regional, warehouse, Mexican, and Canadian accounts, were down $0.2 million to $50.5 million in the second quarter of 2006 from $50.7 million in the same period of 2005.

The Company's gross profit was 51.9% in the second quarter of 2006 compared to 54.7% in the second quarter of 2005. The gross profit decrease of 2.8% was the result of sales from the SteelWorks acquisition and the new commercial industrial accounts at margins significantly lower than the Company average, the impact of metal and fuel commodity cost increases on our products and a change in the Company's existing customer sales mix. The lower margin sales from SteelWorks and commercial industrial accounts had a negative impact of 2.0% on the Company's gross profit. The remaining gross profit decrease was the result of higher product costs from our vendors passing on increased prices for commodities such as plastics, aluminum, copper, zinc, and steel used in the manufacture of sign materials, fasteners, and keys. In addition, the gross profit also decreased from a change in customer mix resulting from increased sales to the lower gross profit customers in national and regional accounts.

The Company's condensed consolidated selling, general and administrative expenses ("S,G&A") increased $2.0 million or 5.5% from $36.4 million in the second quarter of 2005 to $38.4 million in the second quarter of 2006. Selling expenses increased $0.8 million or 4.3% primarily as a result of an increase in service wages and payroll benefits to service the increasing number of new national account stores. Warehouse and delivery expenses increased $1.6 million or 12.6% primarily as a result of increased freight, labor, and shipping supplies on the increased sales volume. General and administrative expenses increased by $0.2 million in the second quarter of 2006 compared to the second quarter of 2005. This increase was primarily the result of higher accounting and professional fees and slightly higher medical claims costs in the 2006 period compared to the 2005 period. The Company recorded a stock compensation gain of $0.2 million in the second quarter of 2006 compared to a charge of $0.4 in the same prior year period as a result of a decrease in the fair market value of stock underlying the options issued.

Depreciation expense of $4.1 million in the second quarter of 2006 was slightly more than depreciation of $3.9 million in the second quarter of 2005.

Amortization expense of $1.9 million in the second quarter of 2006 was slightly more than the amortization of $1.8 million in the same quarter of 2005. The increase in amortization was the result of the acquisition of additional intangible assets from the SteelWorks purchase in January 2006.

The Company recorded management and transaction fees of $0.3 million for the second quarter of 2006 and for the second quarter of 2005. The Company is obligated to pay management fees to a subsidiary of CHS for management services rendered in the amount of fifty-eight thousand dollars per month, plus out-of-pocket expenses, and to pay transaction fees to a subsidiary of Ontario Teacher's Pension Plan for transaction services rendered in the amount of twenty-six thousand dollars per month, plus out of pocket expenses, for each month commencing after March 31, 2004.

Income from operations for the three months ended June 30, 2006 was $14.1 million, a decrease of $0.1 million from the same period of the prior year.

The Company's condensed consolidated operating profit margin from operations (income from operations as a percentage of net sales) decreased from 13.6% in the second quarter of 2005 to 12.5% in the same period of 2006. The operating profit margin benefited from the reduction of SG&A expense together with depreciation and amortization as a percentage of sales, but this benefit was completely offset by the decrease in gross profit as a percentage of sales.

Interest expense, net, increased $1.2 million to $6.4 million in the second quarter of 2006 from $5.2 million in the same period of 2005. The increase in interest expense was the result of an increased LIBOR borrowing rate on the Term B Loan and additional borrowings under the revolving credit facility following the January 5, 2006 SteelWorks acquisition.

Interest expense on the mandatorily redeemable preferred stock and management purchased options was $2.2 million in the second quarter of 2006, an increase of $0.2 million from $2.0 million in the second quarter of 2005. Interest payable on the mandatorily redeemable preferred stock and management purchased options is cumulative and therefore interest expense will continue to increase over time.

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. For the quarters ended June 30, 2006 and 2005, the Company paid $3.1 million in interest on the Junior Subordinated Debentures, which is equivalent to the amounts distributed by the Trust on the Trust Preferred Securities.

The Company also pays interest to the Trust on the Junior Subordinated Debentures underlying the Trust Common Securities at the rate of 11.6% per annum on their face amount of $3.3 million, or $0.4 million per annum in the aggregate. The Trust distributes an equivalent amount to the Company as a distribution on the underlying Trust Common Securities. For the quarters ended June 30, 2006 and 2005, the Company paid $0.1 million interest on the Junior Subordinated Debentures, which is equivalent to the amounts received by the Company as investment income.

The Company recorded an income tax provision of $1.9 million on pre-tax income of $2.5 million in the second quarter of 2006 compared to an income tax provision of $3.8 million on pre-tax income of $3.7 million in the second quarter of 2005. As discussed in Note 8 of the notes to condensed consolidated financial statements, the 2006 provision for income taxes was calculated on a discrete period basis while the 2005 income tax provision was based on the estimated annual effective rate. As a result, the effective income tax rate of 77.5% for the three months ended June 30, 2006 was lower than the 101.0% rate for the comparable period in 2005. The effective income tax rates differed from the statutory income tax rates in both periods primarily as a result of nondeductible interest on the mandatorily redeemable preferred stock and stock compensation expense.

***Results of Operations***

**Sales and Profitability for each of the Six Month Periods Ended June 30,**

| | (dollars in thousands) | | | |
|---|---|---|---|---|
| | 2006 | | 2005 | |
| | Amount | % of Total | Amount | % of Total |
| Net sales | $ 214,883 | 100.0% | $ 190,534 | 100.0% |
| Cost of sales (exclusive of depreciation and amortization shown separately below) | 104,933 | 48.8% | 85,679 | 45.0% |
| Gross profit | 109,950 | 51.2% | 104,855 | 55.0% |
| Operating expenses: | | | | |
| Selling | 38,196 | 17.8% | 36,473 | 19.1% |
| Warehouse & delivery | 27,034 | 12.6% | 23,596 | 12.4% |
| General & administrative | 10,772 | 5.0% | 10,318 | 5.4% |
| Stock compensation expense | 524 | 0.2% | 732 | 0.4% |
| Total SG&A | 76,526 | 35.6% | 71,119 | 37.3% |
| Depreciation | 8,189 | 3.8% | 7,887 | 4.1% |
| Amortization | 3,873 | 1.8% | 3,612 | 1.9% |
| Management and transaction fees | 508 | 0.2% | 533 | 0.3% |
| Total operating expenses | 89,096 | 41.5% | 83,151 | 43.6% |
| Other income (expense) | 319 | 0.1% | (187) | -0.1% |
| Income from operations | 21,173 | 9.9% | 21,517 | 11.3% |
| Interest expense, net | 12,658 | 5.9% | 9,904 | 5.2% |
| Interest expense on mandatorily redeemable preferred stock & management purchased options | 4,288 | 2.0% | 3,845 | 2.0% |
| Interest expense on junior subordinated notes | 6,304 | 2.9% | 6,305 | 3.3% |
| Investment income on trust common securities | (189) | -0.1% | (189) | -0.1% |
| (Loss) income before income taxes | (1,888) | -0.9% | 1,652 | 0.9% |

**Six Months Ended June 30, 2006 and 2005**

Net sales increased $24.4 million, or 12.8%, in the first half of 2006 to $214.9 million from $190.5 million in the first half of 2005. Sales of threaded rod products to the newly acquired SteelWorks accounts represented $14.6 million of the $24.4 million increase.

Sales of the remaining Company products, excluding sales to SteelWorks' accounts, were $9.8 million of the total $24.4 million sales increase in the first half of 2006. Sales to national accounts represented $5.1 million of the remaining $9.8 million total sales increase primarily as a result of increased fastener sales to Lowe's and increased sales of keys and LNS to Lowe's and Home Depot. Sales to WW Grainger in the newly created commercial industrial accounts were $2.2 million in the first half of 2006 compared to no sales in the same prior year period. Sales of engraving products increased $1.9 million and sales to franchise and independent ("F&I") accounts increased $0.8 million in the first half of 2006. Other sales, including regional accounts, warehouse, Mexican, and Canadian accounts, were down $0.2 million to $26.5 million in the first half of 2006 from $26.7 million in the same period of 2005.

The Company's gross profit was 51.2% in the first half of 2006 compared to 55.0% in the first half of 2005. The gross profit decrease of 3.8% was the result of the unfavorable combination of new sales generated from the SteelWorks acquisition and the new commercial industrial account at margins significantly less than the prior year together with higher costs for our products and a change in the Company's existing customer sales mix. The lower margin sales from SteelWorks and commercial industrial accounts had a negative impact of 2.1% on the Company's gross profit. The remaining gross profit decrease was the result of higher product costs from our vendors passing on increased prices for commodities such as plastics, aluminum, copper, zinc, and steel used in the manufacture of sign materials, fasteners, and keys. In addition, the gross profit also decreased from a change in customer mix resulting from increased sales to the lower gross profit customers in national and regional accounts.

The Company's condensed consolidated selling, general and administrative expenses ("S,G&A") increased $5.4 million or 7.6% from $71.1 million in the first half of 2005 to $76.5 million in the first half of 2006. Selling expenses increased $1.7 million or 4.7% primarily as a result of an increase in service wages and payroll benefits to service the increasing number of new national account stores. Warehouse and delivery expenses increased $3.4 million or 14.4% primarily as a result of increased freight, labor, and shipping supplies on the increased sales volume. General and administrative expenses increased by $0.5 million in the first half of 2006 compared to the first half of 2005. This increase was primarily the result of higher accounting and professional fees in the 2006 period compared to the 2005 period. The Company recorded a stock compensation charge of $0.5 million in the first half of 2006 which was less than the charge of $0.7 in the same prior year period as a result of a decrease in the fair market value of stock underlying the options issued.

Depreciation expense of $8.2 million in the first half of 2006 was slightly more than depreciation of $7.9 million in the first half of 2005.

Amortization expense of $3.9 million in the first half of 2006 was $0.3 million more than the amortization of $3.6 million in the same period of 2005. The increase in amortization was the result of the acquisition of additional intangible assets from the SteelWorks purchase in January 2006.

The Company recorded management and transaction fees of $0.5 million for the first half of 2006 and for the first half of 2005. The Company is obligated to pay management fees to a subsidiary of CHS for management services rendered in the amount of fifty-eight thousand dollars per month, plus out-of-pocket expenses, and to pay transaction fees to a subsidiary of Ontario Teacher's Pension Plan for transaction services rendered in the amount of twenty-six thousand dollars per month, plus out of pocket expenses, for each month commencing after March 31, 2004.

Income from operations for the six months ended June 30, 2006 was $21.2 million, a decrease of $0.3 million from the same period of the prior year.

The Company's condensed consolidated operating profit margin from operations (income from operations as a percentage of net sales) decreased from 11.3% in the first half of 2005 to 9.9% in the same period of 2006. The operating profit margin benefited from the reduction of SG&A expense together with depreciation and amortization as a percentage of sales, but this benefit was completely offset by the decrease in gross profit as a percentage of sales.

Interest expense, net, increased $2.8 million to $12.7 million in the first half of 2006 from $9.9 million in the same period of 2005. The increase in interest expense was the result of an increased LIBOR borrowing rate on the Term B Loan and additional borrowings under the revolving credit facility following the January 5, 2006 SteelWorks acquisition.

Interest expense on the mandatorily redeemable preferred stock and management purchased options was $4.3 million in the first half of 2006, an increase of $0.5 million from $3.8 million in the first half of 2005. Interest payable on the mandatorily redeemable preferred stock and management purchased options is cumulative and therefore interest expense will continue to increase over time.

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. For the six months ended June 30, 2006 and 2005, the Company paid $6.1 million in interest on the Junior Subordinated Debentures, which is equivalent to the amounts distributed by the Trust on the Trust Preferred Securities.

The Company also pays interest to the Trust on the Junior Subordinated Debentures underlying the Trust Common Securities at the rate of 11.6% per annum on their face amount of $3.3 million, or $0.4 million per annum in the aggregate. The Trust distributes an equivalent amount to the Company as a distribution on the underlying Trust Common Securities. For the six months ended June 30, 2006 and 2005, the Company paid $0.2 million interest on the Junior Subordinated Debentures, which is equivalent to the amounts received by the Company as investment income.

The Company recorded an income tax provision of $1.4 million on a pre-tax loss of $1.9 million in the first six months of 2006 compared to an income tax provision of $2.0 million on pre-tax income of $1.7 million 2005. As discussed in Note 8 of the notes to condensed consolidated financial statements, the 2006 interim provision for income taxes was calculated on a discrete period basis while the 2005 income tax provision was based on the estimated annual effective rate. As a result, the effective income tax rate of -75.6% for the six months ended June 30, 2006 was significantly different than the 122.0% rate for the comparable period in 2005. The effective income tax rates differed from the statutory income tax rates in both periods primarily as a result of nondeductible interest on the mandatorily redeemable preferred stock and stock compensation expense.

## Cash Flows

The statements of cash flows reflect the changes in cash and cash equivalents for the six months ended June 30, 2006 and 2005 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 routine operating activities represented by changes in inventories, accounts receivable, accounts payable, and other assets & liabilities plus the net income or loss adjusted for non-cash charges for depreciation, amortization, deferred taxes, PIK interest, interest on mandatorily redeemable preferred stock and management purchased options.

Cash used for operating activities was $1.9 million in the first six months of 2006 compared to cash used of $16.5 million for the same period of 2005. Operating cash outflows have historically been greatest in the first two fiscal quarters as selling volume and inventory levels generally increase as the Company approaches the stronger spring and summer selling seasons. The seasonal working capital impact was less in the first six months of 2006 compared to the same period in 2005. The seasonal inventory build in the first half of 2005 was greater than usual as the Company increased its stock of product sourced from overseas in anticipation of potential congestion at the West Coast ports. As a result, cash used for the seasonal inventory build was $11.8 million lower in the first half of 2006. The increase in accounts payable of $10.5 million in the first half of 2006 provided $7.6 million more cash than the comparable period in 2005. The increase in accounts receivable of $16.7 million in the first half of 2006 used $1.6 million more cash than in 2005.

**Investing Activities**

Net cash used for investing activities was $41.9 million for the first six months of 2006 compared to $8.4 million for the same prior year period. The SteelWorks acquisition for $34.2 million in January 2006 was the primary reason for the increase in investing activities from the prior year.

The principal recurring investing activities are property additions primarily for key duplicating machines. Net property additions for the first six months of 2006 were $7.7 million compared to $8.3 million in the comparable prior year period. The $0.6 million decrease in capital expenditures in the first half of 2006 compared to the prior year period was primarily due to a decrease of $1.5 million in expenditures for leasehold improvements. The 2005 expenditures for leasehold improvements included $1.6 million related to the expansion of the Cincinnati office location and the relocation and build out of the Tempe office location. The amount of expenditures for key duplicating machines decreased slightly to $4.2 million in the first half of 2006 compared to $4.5 million in 2005. These reductions were partially offset by an increase in expenditures of $1.4 million for computer equipment and software primarily used for operational enhancements.

**Financing Activities**

Net cash provided by financing activities for the six months ended June 30, 2006 was $19.5 million compared to net cash used of $1.1 million for the comparable period in 2005. The current year period includes $21.2 million in cash provided by borrowings on the revolving credit facility compared to no activity on the revolving credit facility in the prior year period. The Company's cash balances, rather than revolver borrowings, were used to fund the seasonal increase in working capital requirements for the first six months of 2005.

***Liquidity and Capital Resources***

The Company's working capital position (defined as current assets less current liabilities) of $97.2 million at June 30, 2006 represents a decrease of $7.2 million from the December 31, 2005 level of $104.4 million. The primary factor for this decrease in working capital was the use of approximately $27.0 million in cash together with borrowings of approximately $7.2 million from the revolving credit facility for the acquisition of SteelWorks. The resulting reduction in working capital was partially offset by the seasonal increase in inventories and accounts receivable of $22.8 million. The Company's current ratio (defined as current assets divided by current liabilities) decreased to 2.78x at June 30, 2006 from 3.11x at December 31, 2005.

The Company's contractual obligations in thousands of dollars as of June 30, 2006 are summarized below:

| Contractual Obligations | Total | Payments Due: Less Than 1 Year | 1 to 3 Years | 3 to 5 Years | More Than 5 Years |
|---|---|---|---|---|---|
| Junior Subordinated Debentures (1) | $ 117,098 | $ — | $ — | $ — | $ 117,098 |
| Long Term Senior Term Loans | 212,606 | 2,175 | 4,350 | 206,081 | — |
| Bank Revolving Credit Facility | 21,233 | — | — | — | 21,233 |
| Long Term Unsecured Subordinated Notes | 49,727 | — | — | — | 49,727 |
| Interest Payments (2) | 97,948 | 22,680 | 44,783 | 29,243 | 1,242 |
| Operating Leases | 49,524 | 8,429 | 10,562 | 7,958 | 22,575 |
| Mandatorily Redeemable Preferred Stock | 73,708 | | | | 73,708 |
| Management Purchased Options | 4,362 | | | | 4,362 |
| Deferred Compensation Obligations | 4,959 | 408 | 816 | 816 | 2,919 |
| Capital Lease Obligations | 421 | 122 | 191 | 58 | 50 |
| Other Long Term Obligations | 4,865 | 1,218 | 800 | 396 | 2,451 |
| Total Contractual Cash Obligations | $ 636,451 | $ 35,032 | $ 61,502 | $ 244,552 | $ 295,365 |

(1) The junior subordinated debentures liquidation value is approximately $108,707.

(2) Interest payments for Long Term Senior Term Loans and Long Term Unsecured Subordinated Notes. Interest payments on the variable rate Long Term Senior Term Loans were calculated using actual interest rates through June 30, 2006 and a LIBOR rate plus applicable margin of 8.375% thereafter.

All of the obligations noted above are reflected on the Company's condensed consolidated balance sheet as of June 30, 2006 except for the operating leases and interest payments.

The Company had approximately $233.8 million of outstanding debt under its collateralized credit facilities at June 30, 2006, consisting of $212.6 million in a term loan, $21.2 million in revolving credit borrowings, and $0.3 million in capitalized lease obligations. The term loan consisted of a $212.6 million Term B Loan (the "Term Loan B") currently at a three (3) month LIBOR rate plus margin of 8.375%. The revolver borrowings consist of $11.2 million currently at a one (1) month LIBOR rate of 8.25%, $7.0 million currently at a one (1) month LIBOR rate of 8.1875%, and $3.0 million currently at a three (3) month LIBOR rate of 8.1875%. The capitalized lease obligations were at various interest rates.

As of June 30, 2006, the Company had $13.3 million available under its $40 million revolving credit facility. Availability under the revolving credit facility was reduced by outstanding borrowings of $21.2 million and outstanding letters of credit of $5.5 million.

As of June 30, 2006, the Company had purchase commitments of $0.3 million for marine cargo contracts and no material purchase commitments for capital expenditures.

Interest on the Subordinated Debt Issuance of $47.5 million which matures September 30, 2011 is at a fixed rate of 13.5% per annum, with cash interest payments being required on a quarterly basis at a fixed rate of 11.25% commencing April 15, 2004. The outstanding principal balance of the Subordinated Debt Issuance shall be increased on a quarterly basis at the remaining 2.25% fixed rate (the "PIK Amount"). All of the PIK Amounts are due on the maturity date of the Subordinated Debt Issuance. As of June 30, 2006, the outstanding Subordinated Debt Issuance including the PIK Amounts was $49.7 million.

The Senior Credit Agreement, among other provisions, contains financial covenants requiring the maintenance of specific leverage and interest coverage ratios and levels of financial position, restricts the incurrence of additional debt and the sale of assets, and permits acquisitions with the consent of the lenders. The Company was in full compliance with all provisions of the Senior Credit Agreement as of June 30, 2006.

### *Critical Accounting Policies and Estimates*

Significant accounting policies and estimates are summarized in the footnotes to the condensed consolidated financial statements. Some accounting policies require management to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. Such judgments are subject to an inherent degree of uncertainty. These judgments are based on our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. Management believes these estimates and assumptions are reasonable based on the facts and circumstances as of June 30, 2006, however actual results may differ from these estimates under different assumptions and circumstances.

We identified our critical accounting policies in Management's Discussion and Analysis of Financial Condition and Results of Operations found in our Annual Report on Form 10-K for the year ended December 31, 2005. We believe there have been no changes in these critical accounting policies. We have summarized our critical accounting policies either in the notes to the condensed consolidated financial statements or below:

**Stock-Based Compensation:**

Effective January 1, 2006, the company adopted Statement of Financial Accounting Standards ("SFAS") No. 123(R), Share-Based Payment, ("SFAS No. 123(R)") using the modified prospective method. SFAS No. 123(R) requires entities to recognize the cost of employee services in exchange for awards of equity instruments based on the grant-date fair value of those awards (with limited exceptions). That cost, based on the estimated number of awards that are expected to vest, will be recognized over the period during which the employee is required to provide the service in exchange for the award. No compensation cost is recognized for awards for which employees do not render the requisite service.

Compensation cost for the unvested portions of equity-classified awards granted prior to January 1, 2006, will be recognized in the results of operations on a straight line basis over the remaining vesting periods. Changes in fair value of unvested liability instruments during the requisite service period will be recognized as compensation cost over that service period. Changes in the fair value of vested liability instruments during the contractual term will be recognized as an adjustment to compensation cost in the period of the change in fair value.

Due to the prospective adoption of SFAS No. 123(R), results for prior periods have not been restated.

See Note 10, Stock-Based Compensation, of the notes to condensed consolidated financial statements for further discussion of stock-based compensation and SFAS No. 123(R).

**Revenue Recognition:**

Revenue is recognized when products are shipped or delivered to customers depending upon when title and risks of ownership have passed.

The Company offers a variety of sales incentives to its customers primarily in the form of discounts, rebates and slotting fees. 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. Slotting fees are used on an infrequent basis and are not considered to be significant. Discounts, rebates and slotting fees are included in the determination of net sales.

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

**Accounts Receivable and Allowance for Doubtful Accounts:**

The Company establishes an allowance for doubtful accounts using the specific identification method and also provides a reserve in the aggregate. The estimates for calculating the aggregate reserve are based on historical information. The allowance for doubtful accounts was $501 as of June 30, 2006 and $434 as of December 31, 2005.

**Inventory Realization:**

Inventories consisting predominantly of finished goods are valued at the lower of cost or market, cost being determined principally on the weighted average cost 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 twenty-four month period or with on hand quantities in excess of twenty-four months average usage. The inventory reserve amounts were $5,511 as of June 30, 2006 and $3,948 as of December 31, 2005.

**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.

**Self-insurance Reserves:**

The Company self insures its product liability, worker's compensation and general liability losses up to $250 thousand per occurrence. Catastrophic coverage is maintained for occurrences in excess of $0.25 million up to $35.0 million.

The Company self insures its group health claims up to an annual stop loss limit of $175 thousand per participant. Aggregate coverage is maintained for annual group health insurance claims in excess of 125% of expected claims.

Provisions for losses expected under these programs are recorded based on an analysis of historical insurance claim data and certain actuarial assumptions.

***Inflation***

The Company is sensitive to inflation present in the economies of the United States and our foreign suppliers located primarily in Taiwan and China. Inflation in years prior to 2004 produced only a modest impact on the Company's operations. However, the recent growth in China's economic activity has increased overall demand for materials used in the manufacture of our products. This increased demand produced cost increases for certain of our fastener products which exceeded the prevailing rate of inflation in the latter part of 2003 and throughout most of 2004. The fastener prices from our foreign suppliers were stabilized during 2005. However, recent increases in costs for commodities such as copper, zinc, aluminum, and steel have had an unfavorable impact on the cost of key and threaded rod prices from our domestic suppliers. Additionally, the increases in the cost of diesel fuel have contributed to transportation rate increases. Continued inflation and resulting cost increases over a period of years 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. The Company was able to recover most of the 2003 and 2004 fastener cost increases by raising prices to its customers. The Company has initiated pricing action on the effected product lines which will be effective starting in the third quarter of 2006. This pricing action is expected to offset the unfavorable impact of commodity cost increases incurred to date.

***Forward Looking Statements***

Certain disclosures related to acquisitions and divestitures, refinancing, capital expenditures, resolution of pending litigation and realization of deferred tax assets contained in this quarterly report involve substantial risks and uncertainties and may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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.

These forward-looking statements are not historical facts, but rather are based on management’s current expectations, assumptions and projections about future events. Although management believes that the expectations, assumptions and projections on which these forward-looking statements are based are reasonable, they nonetheless could prove to be inaccurate, and as a result, the forward-looking statements based on those expectations, assumptions and projections also could be inaccurate. Forward-looking statements are not guarantees of future performance. Instead, forward-looking statements are subject to known and unknown risks, uncertainties and assumptions that may cause the Company’s strategy, planning, actual results, levels of activity, performance, or achievements to be materially different from any strategy, planning, 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, 2005. Given these uncertainties, current or prospective investors are cautioned not to place undue reliance on any such forward-looking statements.

All forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by the cautionary statements included in this report and the risk factors referenced above; they should not be regarded as a representation by the Company or any other individual. 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 or be materially different from those discussed.

**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 the Company's policy to enter into interest rate transactions only to the extent considered necessary to meet objectives. On April 28, 2004, the Company entered into an Interest Rate Swap Agreement ("Swap") with a two-year term for a notional amount of $50 million. The Swap fixed the interest rate on $50 million of the Senior Term Loan at a rate of 1.17% plus the applicable interest rate margin for the first three months of the Swap with incremental increases ranging from 28 to 47 basis points in each successive quarter. This Swap was in effect during the first and second quarters of this year until its expiration on April 28, 2006. Based on Hillman's exposure to variable rate borrowings at June 30, 2006, a one percent (1%) change in the weighted average interest rate for a period of one year would change the annual interest expense by approximately $2.3 million.

The Company is exposed to foreign exchange rate changes of the Canadian and Mexican currencies as it impacts the $2.5 million net asset value of its Canadian and Mexican subsidiaries as of June 30, 2006. Management considers the Company's exposure to foreign currency translation gains or losses to be minimal.

**Item 4.**

***Controls and Procedures***

Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the chief executive officer and the chief financial officer, of the effectiveness of the design and operation of the 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"). Based upon that evaluation, which included the matters discussed below, the Company's chief executive officer and chief financial officer concluded that the Company's disclosure controls and procedures were not effective, as of the end of the period covered by this Report (June 30, 2006), in ensuring that material information relating to The Hillman Companies, Inc. required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to management, including the chief executive officer and the chief financial officer, as appropriate, to allow timely decisions regarding required disclosure. Notwithstanding the material weaknesses described below, the Company's management has concluded that the condensed consolidated financial statements included in this quarterly report fairly state, in all material respects, the Company's financial condition, results of operations and cash flows for the periods presented in conformity with generally accepted accounting principles ("GAAP").

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Although we have not yet been required to assess and report on the effectiveness of our internal control over financial reporting, as a result of the restatement described above, the Company concluded that the material weaknesses described below existed as of June 30, 2006.

(1) The Company did not maintain effective controls over the timing of the recognition of revenue. Specifically, revenue recognition determination was not reflective of contract terms related to when title and risk of loss transferred to the customer in order to record revenue in accordance with GAAP. This control deficiency resulted in the restatement of the Company's 2002 consolidated financial statements, interim and annual consolidated financial statements for the year ended December 31, 2003, the three months ended March 31, 2004 and June 30, 2004, the three and six months ended September 30, 2004, the nine months ended December 31, 2004, the three months ended March 31, 2005, as well as audit adjustments to the 2005 consolidated financial statements affecting revenue, cost of sales, deferred revenue and other current assets.

(2) The Company did not maintain effective controls over its accounting for income and other taxes required under GAAP. Specifically, the Company did not maintain a sufficient complement of personnel within its tax accounting function with the appropriate level of knowledge, experience and training in the application of GAAP related to income and other taxes. This control deficiency contributed to the following:

- Deferred income tax balances related to purchase business combinations were not appropriately determined to ensure that deferred income tax liabilities and allocated goodwill were fairly stated in accordance with GAAP;
- Quarterly income tax provisions were not appropriately determined utilizing an estimate of the annual effective tax rate;
- The annual income tax provision was calculated using an inappropriate estimate of federal and state statutory tax rates;
- Deferred tax balances were not accurate;
- The income tax provision did not appropriately reflect the tax effect of stock option exercises in accordance with GAAP;
- Valuation allowances for state tax operating loss carryforwards were overstated based on loss carryforward periods and estimates of future state taxable income;
- Changes in valuation allowances and reserves for uncertain tax positions established in purchase business combinations were incorrectly charged to income tax expense instead of goodwill;
- State income and franchise tax provisions and the related tax payable accounts were incorrectly calculated;
- Certain book versus tax basis differences were based on estimates which were not updated on a timely basis and certain temporary differences were incorrectly treated as permanent items; and
- State franchise taxes were incorrectly included as a component of income tax expense instead of operating expenses.

This control deficiency resulted in the restatement of the Company’s 2002 consolidated financial statements, interim and annual consolidated financial statements for the year ended December 31, 2003, the three months ended March 31, 2004, the nine months ended December 31, 2004, the three months ended March 31, 2005 as well as audit adjustments to the 2005 consolidated financial statements.

(3) The Company did not maintain effective controls over its accounting for outstanding checks. Specifically, the Company did not maintain effective controls to properly reclassify outstanding checks in excess of available deposits from cash to accounts payable, accrued salaries and wages and the revolver and to properly report cash flows from operating and financing activities. This control deficiency resulted in the restatement of the Company’s 2002 consolidated financial statements, interim and annual consolidated financial statements for the year ended December 31, 2003, the three months ended March 31, 2004, the nine months ended December 31, 2004, the three months ended March 31, 2005 as well as audit adjustments to the 2005 consolidated financial statements.

Additionally, each of these control deficiencies could result in a misstatement of the aforementioned account balances or disclosures that would result in a material misstatement to the annual or interim financial statements that would not be prevented or detected.

Accordingly, management has determined that each of the above control deficiencies represents a material weakness.

Plan for Remediation of Material Weaknesses

Management is in the process of remediating these material weaknesses in internal control over financial reporting. In particular, we intend to:

- Increase our training and resources in the income tax accounting area;
- Expand review procedures and controls related to unique and specialized transactions;

- Increase review procedures and controls related to income tax accounting;
- Increase review procedures and controls related to sales and marketing initiatives as well as sales contracts and agreements; and
- Review the disclosure committee process and increase the frequency of such meetings from quarterly to monthly.

Management will consider the design and operating effectiveness of these actions and will make any changes management determines are appropriate.

As of June 30, 2006, the Company has taken steps to implement the remedial measures described above. Management of the Company expects remediation of the material weaknesses to be fully implemented by December 31, 2006.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended June 30, 2006, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II
## OTHER INFORMATION

**Item 1. – Legal Proceedings.**

From time to time, we become involved in ordinary, routine or regulatory legal proceedings incidental to the business. As of the date of filing, we were not a party to any material legal proceeding.

**Item 1A. – Risk Factors.**

There have been no material changes to the risks related to the Company.

**Item 2. – Unregistered Sales of Equity Securities and Use of Proceeds.**

Not Applicable

**Item 3. – Defaults Upon Senior Securities.**

Not Applicable

**Item 4. – Submission of Matters to a Vote of Security Holders.**

Not Applicable

**Item 5. – Other Information.**

Not Applicable

**Item 6. – Exhibits.**

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.

## 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 | /s/ Harold J. Wilder |
| James P. Waters<br>Vice President — Finance<br>(Chief Financial Officer) | Harold J. Wilder<br>Controller<br>(Chief Accounting Officer) |

DATE: August 11, 2006

Exhibit 31.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Max W. Hillman, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: August 11, 2006

/s/ Max W. Hillman
Max W. Hillman
Chief Executive Officer

Exhibit 31.2

**CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, James P. Waters, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: August 11, 2006

/s/ James P. Waters
James P. Waters
Chief Financial Officer

Exhibit 32.1

**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 for the quarter ended June 30, 2006, (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
Name: Max W. Hillman
Date: August 11, 2006

Exhibit 32.2

**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 for the quarter ended June 30, 2006, (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

Name: James P. Waters

Date: August 11, 2006