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Compass Diversified Holdings, Inc. (CODI)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Compass Diversified Holdings Fourth Quarter and Full-Year 2019 Earnings Conference Call. Today's call is being recorded. All lines have been placed on mute. [Operator Instructions]

At this time, I'd like to turn the conference over to Matt Berkowitz of The IGB Group for introductions and the reading of the Safe Harbor statement. Sir, please go ahead.

Matthew Berkowitz
Senior Account Executive, The IGB Group

Thank you. And welcome to Compass Diversified Holdings fourth quarter and full-year 2019 conference call. Representing the company today are Elias Sabo, CODI's CEO; Ryan Faulkingham, CODI's CFO; and Pat Maciariello, COO of Compass Group Management.

Before we begin, I would like to point out that the Q4 and full-year 2019 press release, including the financial tables and non-GAAP financial measure reconciliations, are available at the Investor Relations section on the company's website at www.compassequity.com. The company also filed its Form 10-K with the SEC today after the market close, which includes reconciliations of non-GAAP financial measures discussed on this call.

Please note that references to EBITDA in the following discussions refer to adjusted EBITDA as reconciled to net income in the company's financial filings. The company does not provide a reconciliation of its payout ratio which is the ratio of its distribution to its estimated cash flow available for distribution and reinvestment. This is because certain significant information is not available without unreasonable efforts including, but not limited to, the company's future earnings, current taxes, capital expenditures and the distribution to be paid as approved quarterly by the company's board of directors.

Throughout this call, we will refer to Compass Diversified Holdings as CODI or the company.

Now, allow me to read the following Safe Harbor statements. During this conference call, we may make certain forward-looking statements, including statements with regard to the future performance of CODI and its subsidiaries. Words such as believes, expects, projects, and future or similar expressions are intended to identify forward-looking statements. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors could cause actual results to differ on a material basis from those projected in these forward-looking statements and some of these factors are enumerated in the risk factor discussion in the Form 10-K as filed with the Securities and Exchange Commission for the year ended December 31, 2019 as well as in other SEC filings.

In particular, the domestic and global economic environment has a significant impact on our subsidiary companies. Except as required by law, CODI undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Throughout this presentation, references to revenue and EBITDA for Velocity, including Ravin, Foam Fabricators and Sterno, including Rimports are pro forma as if these businesses were acquired on January 1, 2018. Please note that in 2018 CODI acquired Foam Fabricators on February 15, Rimports on February 26, and Ravin on September 4 and their pre-acquisition results described herein are not intended to be indicative of their respective results in the future under our ownership and management or as a measure of our past performance.

At this time, I would like to turn the call over to Elias Sabo.

Elias J. Sabo

Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

Good afternoon. Thank you all for your time and welcome to our fourth quarter and full-year 2019 earnings conference call.

Before discussing our results, I would like to take a step back and briefly touch on some of the principles that have long been the hallmark of our company. Since our IPO nearly 14 years ago, CODI has maintained an unwavering focus on shareholder alignment, investing across niche industrial and branded consumer sectors, and using permanent capital as a strategic asset. As I look back on our performance over the past year, these key differentiators have never been more relevant or produced stronger results.

Our results derived in part from the competitive advantage that we gained through our permanent capital structure. With the flexibility to be patient throughout the year, we remain highly disciplined in how we acquired, actively managed and opportunistically divested leading middle market businesses. In 2019, we completed the divestitures of Clean Earth and Manitoba Harvest, both producing significant gains for shareholders. With these divestitures, we are now proud to have produced more than $1 billion in realized gains. The divestitures of Clean Earth and Manitoba Harvest in 2019 led to a temporary reduction in our size and earnings power. At the same time, we remain disciplined in our capital deployment efforts as we did not find acquisition opportunities that met our strict criteria. Given these dynamics, management decided to waive management fees on excess cash, further demonstrating our unwavering commitment to align with our shareholder interests.

Turning to our financial performance, we are pleased to report fourth quarter revenue and EBITDA growth of 4.3% and 11.1%, respectively, over the fourth quarter of 2018, exceeding our expectations and full-year revenue and EBITDA growth of 1.4% and 2.3%, respectively, over the prior year. During 2019, we started to realize accelerated value creation in our 5.11 subsidiary, capitalizing on substantial infrastructure investments we made in 2017 and 2018. The prospects for 5.11 are strong and we intend to make additional investments throughout 2020 to further accelerate 5.11's growth. And while we are pleased to be generating strong returns for shareholders, we are also taking the necessary steps today to best position our subsidiaries for tomorrow.

During 2019, we embarked on the restructuring of Velocity Outdoor, a key step in driving long-term value creation at Velocity. While these restructuring efforts depressed Velocity's current financial performance, we are confident in both the fundamentals of the business and its leadership team which was enhanced with the additions of industry veterans, Tom McGann as Executive Chairman and Kelly Grindle as Chief Executive Officer.

As part of our ongoing focus on alignment with shareholders, governance and transparency continue to be a top priority. With a board that remains majority independent and has separated the roles of the Chairman and CEO, CODI strives to adhere to a best-in-class governance structure. In 2019, we expanded our board of directors to eight members with the appointment of Larry Enterline, former CEO of Fox Factory. Larry is an exceptional leader and we welcome his business insights and guidance.

Over the past year, CODI has taken important steps to further develop sustainability initiatives across our subsidiaries. We believe it is our responsibility to promote positive change across our subsidiaries and have worked closely with our management teams to implement these initiatives. For example, this past year, Sterno announced that it is going greener with a commitment to reducing its overall carbon footprint by decreasing the amount of steel and chemicals used in its industry-leading products while still delivering the performance required by its customers.

Further, Ergobaby launched its Everlove program, the first of its kind baby carrier buyback and resale program that ensures product quality while dramatically reducing its environmental impact. As we enter 2020, we remain firmly committed to taking a long-term perspective in building our businesses and believe the strategic steps taken in 2019 position CODI to continue creating long-term value for our shareholders. The proceeds of the divestitures of Clean Earth and Manitoba Harvest were used to repay a substantial portion of our indebtedness.

We currently have more capital availability than at any time in our history, and our leverage remains well below our target level at only 1.5 times. Despite the low leverage, we covered our distribution with an 83% payout ratio, exceeding our expectations. These results are a testament to the earnings strength of our subsidiaries and the power of our business model and differentiated approach to return substantial capital to our common shareholders in the form of our $1.44 per share annual distribution.

Our balance sheet provides us ample room to pursue platform acquisitions and support our subsidiaries' management teams, investing capital for organic growth as well as add-on acquisitions. Given the strength of our balance sheet and responsible use of leverage, we are proud to have been rewarded by Moody's in early 2020 with an upgrade of our corporate rating, our senior debt facility and our unsecured bond.

Before I turn the call over to Pat, I would like to briefly discuss the coronavirus impact on our subsidiaries. In recent years, we have been proactive in moving production out of China to reduce our exposure to Chinese tariffs and to diversify and strengthen our supplier base. Although our subsidiaries still procure some limited supply directly from Chinese factories, CODI currently has minimal direct exposure to China, principally where our Ergobaby subsidiary sells products into the Greater Asian marketplaces. As a result, we expect only modest direct impact from the coronavirus at this time. That said, we are actively monitoring the evolving situation and making contingency plan should the coronavirus epidemic extend beyond current expectations. We will continue to be transparent about the expected impact, providing updates, if needed.

With that, I will now turn the call over to Pat to add his comments on our subsidiary companies.

Patrick A. Maciariello

Partner & Chief Operating Officer, Compass Diversified Holdings, Inc.

Thanks, Elias. As we have done since CODI's founding, our focus in 2019 remained on our core business of investing in the middle market across the branded consumer and niche industrial space. Having been exclusively dedicated to these industries for over 20 years, our team was able to further position our subsidiaries for long-term success.

I'll begin with our niche industrial businesses. For the fourth quarter of 2019, revenues declined by 5% and EBITDA increased by 2.6% over the comparable quarter in 2018. For the year, revenue decreased by 2.3% and EBITDA decreased by 0.9% versus 2018, in line with our expectations. Advanced Circuits and Foam Fabricators experienced modest declines in year-to-date 2019 revenue and EBITDA, reflecting a sluggish industrial economy.

Arnold Magnetics grew EBITDA at double-digit rate, reflecting operational improvements and the management team's effort to reposition Arnold towards the aerospace and defense end markets. We're pleased with the results that Dan Miller and our Arnold management team are driving and feel optimistic about Arnold's future under their strategic direction.

Sterno's EBITDA was essentially flat in 2019 as strength in the food service business was offset by weakness in the outdoor category of the consumer products business. As a reminder, the spring season of 2019 was one of the wettest on records and as a result, the outdoor category remained weak. This impacted not only in the spring season but also our fall selling as retailers plan for 2020. Given current inventory levels in the channel, we expect the spring outdoor season for 2020 to be weak as well.

Now, turning to our branded consumer businesses. For the fourth quarter of 2019, revenues and EBITDA increased by 14.9% and 25.8%, respectively, over the comparable quarter in 2018. For the year, revenue and EBITDA increased by 5.3% and 7.3%, respectively, versus 2018, in line with expectations. Ergobaby was down modestly year-to-date as its Tula brand weakened significantly offsetting solid growth in the core Ergobaby brand. We expect the headwinds from Tula to remain at least through the first half of 2020. However, we are more optimistic about the core Ergobaby brand based on early trends in 2020 and new product introductions scheduled for later this year. However, as Elias mentioned, Ergobaby drives a significant amount of revenue from the Greater Asia region and as a result, we expect reduced financial performance in the first half of 2020 as a result of the coronavirus and the negative impact on consumer spending in the region.

Liberty Safe's year-to-date 2019 revenue and EBITDA grew at a rapid pace as a result of distribution gains with a large farm and fleet customer. We expect growth to continue in 2020, however, at a more moderate pace as we comp against selling to this customer later in the year.

Also as Elias mentioned, we embarked on a restructuring of Velocity Outdoor and its financial performance weakened significantly throughout 2019. Velocity's historical distribution channels continue to consolidate and as a result, we are investing in new forms of distribution, including direct-to-consumer. Given the investments needed, we expect Velocity's financial performance in 2020 to be lower than in 2019, with the majority of the decline experienced in the first half of the year.

Finally, 5.11 continues to surpass our expectations, producing 45% EBITDA growth in 2019. Under the leadership of Matt Hyde and Francisco Morales, 5.11 is executing its omni-channel strategy extremely well. We believe the company has significant whitespace and a long growth runway, and we will look to continue to invest in 5.11 to create even better consumer experiences across our channels. We have high conviction that 5.11 has transformational potential for our shareholders and we will continue to invest to maximize this potential.

With that, I will now turn the call over to Ryan to add his comments on our financial results.

Ryan J. Faulkingham

Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

Thank you, Pat. Before I discuss our consolidated financial results for the fourth quarter of 2019, I want to highlight the great strides we have made during 2019 strengthening our balance sheet, enhancing our liquidity and positioning the business with strong cash flow generation which we believe will allow us to cover our distribution on an annual basis moving forward.

As Elias mentioned, we executed two highly successful and opportunistic divestitures during 2019, generating gains in excess of $300 million. In November 2019, the company issued Series C Preferred Shares for net proceeds of $111 million which together with the proceeds from the divestitures allowed us to repay all of our senior indebtedness, including completely repaying our Term Loan B. As Elias mentioned, this brought our leverage to below 1.5 times and with these capital structure changes, we received an upgrade from Moody's on our corporate rating as well as our senior debt facility and unsecured bond. In addition, S&P increased our rating on our unsecured bond.

For the fourth quarter of 2019, we paid a cash distribution of $0.36 per common share in January 2020, representing a current yield of 7.5%. This brings cumulative distributions paid since CODI's 2006 IPO to nearly $18.96 per share or 126% of the IPO price. We also paid cash distributions in January 2020 of approximately $0.45 per share on the 7.25% Series A Preferred Shares and approximately $0.49 per share on our 7.875% Series B Preferred Shares. Both distributions covered the period from and including October 30, 2019 up to but excluding January 30, 2020. Further, we paid distributions in January of 2020 of approximately $0.38 per share on our 7.875% Series C Preferred Shares covering the period from and including November 20, 2019, the original issue date of the Series C Preferred Shares, up to, but excluding January 30, 2020.

Moving to our consolidated financial results for the quarter ended December 31, 2019, I will limit my comments largely to the overall results for our company since the individual subsidiary results are detailed in our Form 10-K that was filed with the SEC earlier today.

On a consolidated basis, revenue for the quarter ended December 31, 2019 was $387 million, up 4.3% compared to $370.9 million for the prior year period. This year-over-year increase reflects strong revenue growth at our branded consumer subsidiaries notably 5.11 and Liberty offset by declines in our niche industrial subsidiaries as previously discussed.

Consolidated net income for the quarter ended December 31, 2019 was $5.4 million. Consolidated net loss for the prior year quarter was $6.5 million. Cash flow available for distribution or reinvestment which we refer to as CAD for the quarter ended December 31, 2019 was $30 million, up 31% from $22.9 million in the prior year period. The increase in CAD during the quarter was primarily the result of 5.11's strong operating performance, lower interest expense and management fees offset by higher maintenance CapEx of our existing businesses and the loss of cash flow from our two divestitures in the first half of 2019. A highlight of our quarterly performance was our ability to generate a substantial increase in consolidated cash flow from our existing businesses as compared to the prior year, notwithstanding the loss of cash flow from Manitoba Harvest and Clean Earth.

Turning now to capital expenditures, during the fourth quarter of 2019, we incurred $7.2 million of maintenance capital expenditures of our existing businesses compared to $3.3 million in the prior year period. The increase in maintenance CapEx was primarily related to a portion of the cost to build out ACI's new facility in Chandler, Arizona. During the fourth quarter of 2019, we continued to invest growth capital spending $5.7 million in the quarter primarily related to ACI's new facility and to support 5.11's long-term growth objectives. Growth CapEx in the prior year quarter was $3.3 million.

Turning now to our expectations for 2020. For 2020, we expect the CAD payout ratio of between 80% and 90%. As a reminder, we executed the sale of Clean Earth in late June of 2019. Clean Earth produced a significant amount of CAD in the first half of 2019 as it paid virtually no cash taxes and there was no management fee paid in the second quarter of 2019. As a result, when comparing the first half of 2020 to the first half of last year, we expect the loss of the Clean Earth cash flow to produce negative comparisons in CAD.

For 2020, we expect consolidated subsidiary EBITDA of between $238 million and $258 million. Please note our expectations for 2020 assume a similar economic growth rate as in 2019. As Elias mentioned earlier, although we don't have significant direct exposure to China and the coronavirus, we do derive secondary supply chain exposure and the continuation of the outbreak could cause our results to [ph] weaken material (00:19:17) from expectation.

As a reminder, we have revenue and earnings seasonality in certain of our subsidiaries and absent any new acquisitions or divestitures, we anticipate a majority of our earnings and cash flow to come in the second half of the year. Further, our quarterly operating and cash flow results can vary materially based on the timing of shipment of large orders or the timing of certain investments made before or after quarter end.

For maintenance capital expenditures in 2020 for our existing eight subsidiaries, we expect to spend between $20 million and $25 million for the full year of 2020. For growth CapEx, we expect to spend between $10 million and $15 million for the full-year 2020 primarily at our 5.11 subsidiary as we support its retail rollout strategy. For 2020 cash taxes for our existing eight subsidiaries, we expect to spend between 6% and 8% of our total – of our subsidiaries total EBITDA.

With that, I will now turn the call back over to Elias.

Elias J. Sabo

Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

Thank you, Ryan. We are proud of our accomplishments in 2019 and believe we are extremely well positioned to continue executing on our strategy in 2020. As you heard, our company's key differentiators are delivering for shareholders and producing real results in today's market.

I would like to close by briefly discussing M&A activity and our forward growth strategy. Middle market M&A activity remains at historically high levels. Debt capital remains robust with favorable terms, and strategic and private equity acquirers continue to seek opportunities to deploy available capital. As a result, valuation multiples remain robust. While traditional private equity players may be pressured to make investment decisions driven by a fund's lifespan instead of fundamentals, we continue to have the flexibility to remain disciplined and patient in how we buy, build and sell leading middle market businesses.

Our acquisition efforts will continue to focus on accretive add-on opportunities and selective platform acquisitions of niche market leaders at valuations where we can expect to exceed our weighted average cost of capital. Going forward, we will maintain an intense focus on executing our proven and disciplined acquisition strategy, improving the operating performance of our companies, opportunistically divesting, distributing sizable distributions and creating long-term shareholder value.

With that, operator, please open up the lines for Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question is from Larry Solow from CJS Securities.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Good afternoon. Congrats on another nice solid year, a lot of things – good things getting done. Just Elias, maybe a couple of questions or just maybe on just on 5.11, obviously a very strong performance, strong quarter, strong year. You mentioned you're going to continue to invest in the business, which completely makes sense. How about just on a margin profile because you've been investing a lot in the margins, I guess, just going up on getting some operating leverage on the great sales growth. Do you expect that to continue? I think you ended the year sort of - [indiscernible] (00:22:39) Q4 is seasonally strong, but I think margins [indiscernible] (00:22:41) 13%, 14% and we're like 12% for the year. So could we expect margins to continue to creep up maybe not as much as if you weren't investing, but what's your outlook there and do you have any outlook for store openings or do you expect the same pace of the back half of 2019 to continue into 2020?

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

A

Yeah. So in terms of margins, Larry, I would say the company had a nice margin pickup in 2019 as we had been forecasting. Some of that margin pickup was due to a number of one-time items that existed in 2018 falling off. But even outside of that, we started to get some good leverage on some of the investments that were made and the shift in revenue mix that's moving much more towards direct-to-consumer has positive margin implication both at the gross margin and at the EBITDA line. So those trends, I would say, are positive and remain in the business as positive margin drivers to be higher going forward.

I would say in 2020 and we wanted to kind of mention this in the script and obviously in Q&A, we think there are some opportunities to improve some of the consumer experiences with 5.11, make it easier through the channels with which we operate. And so there will be additional investments that is going in. A lot of these are technology investments, as you can imagine. And so I would say the rate of margin growth for 2020 we expect to be muted. We think that the company has still really strong top line growth. You see the top line growth that we're experiencing right now. But I would say 2020 being a more investment year, I wouldn't expect a lot of EBITDA margin growth as we invest kind of heavily into some of these omni-channel experiences that are required.

Now that being said, longer term, this company's margin potential is dramatically stronger than where it is today and so I would say, a couple of things. One, we will get continued operating leverage on the business as we grow. Two, there will continue to be a shift towards – in our expectation towards direct-to-consumer which carries higher margins. So we think there is a margin tailwind to the company, part of it though can be held back based on the speed with which we invest and we expect to make some investments at an accelerated rate. Because we think this company has so much potential, we think that's sort of the right thing to do, especially given where we are right now in 2020.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.
A

And Larry, on retail stores, at the end of the year, we had 61 and then as we look to 2020, consistent with prior years, a pace of kind of 1 to 2 a month is the goal, of course that doesn't come very linearly but that's really our internal expectations for 2020.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Okay. What about – just switching gears [indiscernible] (00:25:52) on Sterno, a little bit disappointing year but I think it's not a surprise, the quarter was actually fine. I guess a little bit – you mention on the home and the outdoor side, and it sounds like the inventory will – at least hurt the near-term outlook. But is there anything you guys could – can do to sort of to help that business push it up and get it back up to a little bit of growth or is it just sort of a victim of the weather and whatnot?

Patrick A. Maciariello
Partner & Chief Operating Officer, Compass Diversified Holdings, Inc.
A

Yeah. We're working on several different initiatives, Larry. This is Pat. But I would say the weather hit us this year in the outdoor side. Now you've noticed that's not necessarily the highest margin segment of the business. So its impact was slightly muted but from a revenue side, it was a hit. We're expecting a solid year out of Sterno this year and we're working on a lot of fronts to help ensure that.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Fair enough. And then just lastly, Elias, you mentioned the market is a little – has been for a while little overheated here. And maybe you find something, maybe you don't. But how about just on the strategic tuck-in side, do you guys still feel like there's opportunities in some of your subsidiaries to add things?

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Yeah. We're looking across the board, Larry, add-ons. I would say the market for add-ons got really competitive [ph] as compared to (00:27:12) last year.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Okay.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

And so, even some of the smaller companies started to command some higher valuations.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Right.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Just one thing that I would mention is, we are always open for business for new platforms and we are in absolutely an elevated pricing environment. But when we find extraordinary companies, we will clearly look to be aggressive on great quality companies. I would say last year, we just didn't see a lot of companies that we felt warranted kind of the valuation premiums that were being paid out there.

So as we come into 2020, we are cautiously more optimistic that there's some opportunities both on the platform and add-on side. Now, I will say there's also the coronavirus out there and that will tend to cool everything for a period of time, but assuming that it gets contained and we get back to normalcy, we remain I think more optimistic right now than we were last year in terms of being able to execute against a strategic acquisition.

Larry S. Solow
Analyst, CJS Securities, Inc.
Q

Got it. Great. Appreciate the color. Thanks.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Thank you.

Operator: Your next question is from Kyle Joseph from Jefferies.

Kyle Joseph
Analyst, Jefferies LLC
Q

Hey, good afternoon, guys. Thanks very much for taking my question and congratulations on a strong finish to the year. I had a follow-up for you, Elias. On that note, obviously, we've seen public markets correct given the coronavirus. Can you give us a sense for typically what the lag is in terms of private middle markets in terms of sort of valuation corrections you've seen historically?

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Yeah. I think that it depends on the length of the correction, Kyle, to be honest. So I'll go back to 2018 in December when we had a dramatic correction in equity prices and everybody was worried that there was – the Fed was over-tightening and about to put us into a recession and you saw I think the Russell was even down something like 20% over the course of a month. We didn't see any correction in asset prices in the middle market because it was such an abbreviated time. So I think that if market is going to extended downturns where more important than equity market changes is really the credit markets. And so if we see high yield financing and we see the institutional term markets really start to shut down then asset prices cool dramatically because the financing that is supporting some of these valuations starts to dry up.

So I would say it needs to be a much more elongated likely something that is more global economic recession fears that caused the markets to tie in and asset prices to cool. Now, I will caution one kind of caveat on the other side of that and that is globally there is $1.6 trillion of private equity capital that's been committed but unspent. So we are in somewhat of unchartered waters in terms of the amount of equity capital that sits on the sidelines and it is totally plausible that private equity buyers would be willing to over-equitize a transaction if credit markets were to what would be viewed as maybe a temporary kind of freeze.

So look, we think that asset prices obviously have been very high for the last couple of years, but borrowing costs are extremely low, as we all know right now and capital remains very plentiful. So our view is there's – it's unlikely we're going to see – unless we go into a global recession, it's unlikely we're going to see a material downward change in private market valuations.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. That's very helpful. Thank you for that. And then, two quick ones for Ryan in terms of modeling. Appreciate the color you provided on CapEx, but any sort of seasonality we should expect there or any quarters where it would be heavier than others.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Are you specifically asking about CapEx?

Kyle Joseph
Analyst, Jefferies LLC

Q

Maintenance CapEx, yeah.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Yeah. Okay. I think it's going to be somewhat ratable. It's always tough to determine if one of our subsidiaries is going to put something into service in March or if it falls on April 1 or April 2. I think there's some, I would say that's probably going to be weighted Q1 a little heavy relative to the full year or maybe even Q2. So I'd say definitely more than half in the first half, if that makes sense.

Kyle Joseph
Analyst, Jefferies LLC

Q

Yes. Yes, absolutely. And then last one for me, kind of just checking my math here. But what's the run rate for the preferred distribution going forward. Just want to make sure those are paid quarterly as well on the latest preferred offerings.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Correct, all three series will be paid on – the next would be April 30 for a record date of April 15 and then it will continue on quarter increments from there. That's correct.

Kyle Joseph
Analyst, Jefferies LLC

Q

Okay. And then I'm calculating like a [ph] $5.9 million (00:32:43) number. Am I in the right ballpark?

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

[ph] $0.60, or $6.440 million (00:32:47), yeah, you're talking about the total dollars of distribution?

Kyle Joseph
Analyst, Jefferies LLC

Q

Right.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Yeah, a little over $6 million.

Kyle Joseph
Analyst, Jefferies LLC

Q

Okay, perfect.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Yeah.

Kyle Joseph
Analyst, Jefferies LLC

Q

Thanks very much for answering my questions.

Ryan J. Faulkingham
Executive Vice President, Chief Financial Officer & Co-Compliance Officer, Compass Diversified Holdings, Inc.

A

Sure.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

A

Thank you, Kyle.

Operator: The next question is from Matt Tjaden from Raymond James.

Matthew Tjaden
Analyst, Raymond James & Associates, Inc.

Q

Hi, all. Afternoon. Appreciate the color on the impact of coronavirus as it relates to production. But to kind of dig a little deeper on that, can you give any input or color as it relates to raw materials and any impact coronavirus may have there? Specifically, I guess, the two we'd be interested in would be 5.11 and Sterno.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

A

Yeah, so I would say Sterno has a minor amount of supply that comes directly out of China, it is some of the lower margin on business. It's not overly material. It could be a small drag on their revenue and EBITDA, but it would be pretty immaterial.

Most of Sterno's revenues come from products that are produced, sourced and then produced in the United States and that's both on the portable heat as well as the wax cubes that are the fragrant side of the business. So Sterno, I think we feel pretty good. There could be a little bit of supply impact.

In terms of the – on the raw material, 5.11 and I would say Ergobaby both are soft good companies and although the production is housed outside of China, as we are – a lot of the actual fabrics are sourced from the large mills in China. So it's sort of that next level of kind of supply risk that would exist with these companies. I think being one level removed probably helps to inflate us for a slightly longer period of time from supply disruption than if we were producing directly in China with these companies, but if the coronavirus was to shut down some of the fabric mills that would over an extended period of time clearly impact kind of Ergobaby and 5.11.

Now, we're working aggressively to get backup product, to have backup mills in other areas that would be able to supply it. There would be cost that would end up being incurred and some time, but I would say there is some secondary supply risk that does exist there if this outbreak, which I would also just say feels like it's starting to become more contained in China. We do know that workers are coming back and some of the factories are starting to come back up to speed. So it feels like some of that risk may be reducing right now. But if it is to escalate again in China and the production is to move back down again, there would be longer term secondary supply risk.

Matthew Tjaden
Analyst, Raymond James & Associates, Inc.
Q

All right. Thank you. All of my questions have been answered besides that. Thanks, guys.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Thank you, Matt.

Operator: [Operator Instructions] The next question is from Jeff John from American Century.

Jeffrey P. John
Vice President & Senior Portfolio Manager, American Century Investment Management, Inc.
Q

Hey, good afternoon. Could you guys spend a couple of minutes talking about some of the weaker segments in the quarter and really through the year and maybe Foam Fabricators? And then, maybe give us a little bit more color on some of the turnaround efforts that the new team at Velocity are making. It seems like we've been kind of going through this drag of some larger customer consolidation issues for a while now and I'm wondering if there's any light at the end of that tunnel?

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.
A

Sure, Jeff. I'll pass to answer your Foam Fabricators and Velocity questions.

Patrick A. Maciariello
Partner & Chief Operating Officer, Compass Diversified Holdings, Inc.
A

Yeah. Foam Fabricators, I'd say there was some minimal customer loss that wasn't really the largest part of the impact. I'd say we had a large customer transition to a new platform which didn't go exactly as planned and has caused some delays and continued to cause some slowdowns in our shipment to that customer. And then I just say it's the general industrial slight slowdown. I mean, we're selling here a big part of the business is white goods and we're filling it. Did you want to take Velocity or would you like me to?

I'd say on the Velocity side, we're looking more on these things, I mean, we've done this before and we've been in these sort of transitions before. We were there with 5.11. Manitoba Harvest had some tough times and we've been able to make the right decisions and make the hard decisions to kind of pull these businesses out of it. I think at the Velocity side in particular, there are some operational savings that we think are available but I think also we're really trying to ignite that end demand of the consumer and really kind of have more of a [ph] pull focus (00:37:53) than the company has had historically and we're confident it will pay off.

Jeffrey P. John
Vice President & Senior Portfolio Manager, American Century Investment Management, Inc.

Q

Is there anything competitively in the Velocity business that's causing the issue or is it just lack of demand from those categories?

Patrick A. Maciariello
Partner & Chief Operating Officer, Compass Diversified Holdings, Inc.

A

I would say it's a changing channel in some of the big box and how much a couple of our bigger box customers are carrying. And that will obviously have a greater impact kind of quickly and then kind of trail off over time and actually I say that's the major one. I'd say on the flip side, the activity rates and participation rates are not declining as materially at all.

Jeffrey P. John
Vice President & Senior Portfolio Manager, American Century Investment Management, Inc.

Q

All right. Thanks.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

A

Thank you, Jeff.

Operator: I am showing no further questions at this time. I would like to turn it back to Mr. Elias Sabo for closing.

Elias J. Sabo
Partner, Chief Executive Officer & Director, Compass Diversified Holdings, Inc.

Right. I'd like to thank, everyone, again for joining us on today's call and for your continued interest in CODI. We look forward to sharing our progress with you in the future. Thank you.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation and have a wonderful day.