02-May-2019

Compass Diversified Holdings, Inc. (CODI)

Q1 2019 Earnings Call

CORPORATE PARTICIPANTS

Matthew Berkowitz
Senior Account Executive, Compass Diversified Holdings, Inc.

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

David P. Swanson
Partner, Manager-East Coast Office, Compass Group Management LLC

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

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

OTHER PARTICIPANTS

Kyle Joseph
Analyst, Jefferies LLC

Larry S. Solow
Analyst, CJS Securities, Inc.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. And welcome to the Compass Diversified Holdings First Quarter 2019 Conference Call. Today's call is being recorded. All lines have been placed on mute. [Operator Instructions]

At this time, I would like to turn the conference over to Matt Berkowitz of The IGB Group for introductions and the reading of the Safe Harbor statement. Please go ahead, sir.

Matthew Berkowitz
Senior Account Executive, Compass Diversified Holdings, Inc.

Thank you. And welcome to Compass Diversified Holdings first quarter 2019 conference call. Representing the company today are Elias Sabo, CODI's CEO and a Founding Partner of Compass Group Management, and Ryan Faulkingham, CFO. Also joining us today are Pat Maciariello, a partner and COO of Compass Group Management; and Dave Swanson, a partner of Compass Group Management.

Before we begin, I would like to point out that the Q1 press release including the financial tables and non-GAAP financial measure reconciliations are available on the company's website at www.compassdiversifiedholdings.com. The company also filed its Form 10-Q with the SEC last night, 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 the ratio of its estimated cash flow available for distribution and reinvestment to its distribution. This is because certain significant information is not available without unreasonable efforts including, but not limited to, our company's future earnings, current taxes, capital expenditures and the distribution to be paid as approved quarterly by our 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 statement. During this conference call, we may make certain forward-looking statements, including statements with regard to the future performance of CODI. 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-Q as filed with the Securities and Exchange Commission for the quarter ended March 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.

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 morning. Thank you all for your time, and welcome to our first quarter earnings conference call. We are pleased with our performance in the first quarter of 2019, delivering solid financial results that exceeded our expectations. During the first quarter, we announced the sale of Manitoba Harvest to Tilray Corporation, with the transaction closing on February 28, 2019. We recognized a $121.7 million gain on the sale. We received $110 million in cash proceeds and just under 1 million shares of Tilray stock at closing.

During the month of March, we sold our Tilray shares netting cash proceeds of $68 million. The total cash receipts of $178 million were used to repay borrowings on our revolving line of credit. The transaction also provides for a payment of approximately $48 million, six months from the closing at the end of August. The sale of Manitoba Harvest is expected to be neutral to slightly positive to CAD for the remainder of 2019.

At the end of the first quarter, we announced the promotion of Pat Maciariello to Chief Operating Officer of Compass Group Management. Pat has been a longtime partner with Compass Group Management and has been a member of the Investment Committee along with Dave Swanson, Ryan Faulkingham and me. I'd like to congratulate Pat on his promotion and look forward to working with him in his new role.

Now turning to our financial performance. Throughout this presentation, when we refer to adjusted results, revenue and EBITDA for Velocity including Ravin, Foam Fabricators and Rimports, we refer to pro formas as if these businesses were acquired on January 1, 2018. Please note that in 2018, we acquired Foam Fabricators on February 15, Rimports on February 26, and Raven 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.

During the first quarter, consolidated subsidiary revenue and EBITDA increased by 1.9% and 4% respectively on a pro forma basis from the first quarter of 2018, exceeding our expectations. Our industrial businesses continued to perform above our expectations with revenue and EBITDA growth of 3.7% and 5.9% respectively over 2018.

Dave will provide further details in his section. Our consumer businesses also performed above our expectations. Revenues declined by 0.6% and EBITDA grew by 0.4% as compared to the first quarter of 2018. Pat will provide further details in his section.

For the three months ended March 31, 2019, CODI generated cash flow available for distribution and reinvestment, which we refer to as CAD of $17.6 million, representing growth of 26% over prior year. Our Q1 CAD exceeded our expectations in part as a result of better than expected subsidiary EBITDA growth, and in part due to reduced capital expenditures and cash taxes.

As a reminder, our capital expenditures and cash taxes can vary greatly from quarter-to-quarter. And we anticipate the lower capital expenditures and cash taxes from the first quarter to be made up for over the balance of the year. We are pleased with our financial performance to start the year, and continue to expect slightly above-trend consolidated subsidiary annual EBITDA growth, yielding an annual CAD payout ratio of 75% to 95%. Ryan will provide further details in his comments.

For the fourth quarter, we paid a cash distribution of $0.36 per common share, representing a current yield of 8.8%. This brings cumulative distributions paid since CODI's 2006 IPO to $17.88 per share. We also paid cash distributions on April 30 of approximately $0.45 per share on our 7.25% Series A Preferred Shares, and approximately $0.49 per share on our 7.875% Series B Preferred Shares. Both distributions cover the period from and including January 30, 2019 up to but excluding April 30, 2019.

I will now turn over the call to Dave to review our niche industrial subsidiaries 2019 first quarter performance.

David P. Swanson

Partner, Manager-East Coast Office, Compass Group Management LLC

Thanks, Elias. On a pro forma adjusted basis, first quarter revenues for our niche industrial businesses increased by 3.7%, while EBITDA increased by 5.9% compared to 2018 exceeding our expectations. Starting with Advanced Circuits, the first quarter revenue increased by 4.6% and EBITDA increased 6.9% compared to the prior year, meeting our expectations.

Arnold's first quarter revenue increased by 2.1%; however, EBITDA fell by 5.5% from 2018. Arnold's EBITDA margin decreased from 11.6% to 10.7% due principally to foreign exchange rate losses. Excluding foreign exchange rate changes, Arnold met our expectations for the first quarter.

Clean Earth's first quarter revenue increased 9.3% and EBITDA increased 22.7% from 2018, meeting our expectations. Clean Earth continued to experience solid organic growth across its hazardous waste service line and continues to benefit from add-on acquisitions completed in 2018.

The Sterno Group's first quarter revenue increased 1.3%; however, EBITDA decreased 3.5% from 2018, meeting our expectations. Sterno's first quarter margins were lower due to a revenue mix shift. We continue to expect solid performance for The Sterno Group in 2019. However, we expect our second quarter to be roughly flat with 2018 due to some large orders for Sterno Home moving out of second quarter 2019 and into the third quarter of 2019.

Lastly, Foam Fabricators' first quarter revenue increased 0.6% and EBITDA increased 14.4% compared to the prior year, exceeding our expectations. As a reminder, Foam Fabricators' margins can expand and contract based on the timing of raw material price changes and the corresponding price adjustment mechanisms with our customers. Foam Fabricators benefited from this in the first quarter. However, we expect this to be a slight headwind in the second quarter.

I will now turn over the call to Pat to review our branded consumer subsidiaries' first quarter 2019 performance.

Patrick A. Maciariello

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

Thanks, Dave. On a pro forma basis, first quarter revenues for our branded consumer businesses decreased 0.6% while EBITDA increased 0.4% compared to 2018. Beginning with Liberty Safe, first quarter revenue decreased 5.3% and EBITDA decreased 33.6% from 2018, meeting our expectations. Liberty Safe's first quarter margins were negatively impacted by manufacturing and overhead variances. We expect these negative variances to subside going forward. And we continue to expect Liberty Safe to produce annual financial results for 2019 that are consistent with 2018.

Ergobaby's first quarter revenue increased 1.3% and EBITDA increased 19.1% from 2018 meeting our expectations. Velocity Outdoor's first quarter revenue decreased 11.7% and EBITDA decreased 34.5% from 2018, meeting our expectations. Throughout the first half of 2019, we felt difficult comparisons for Velocity as Velocity fulfilled a large JROTC order in the first half of 2018 that is not repeating in 2019.

In addition, we expect Ravin which we acquired in September of 2018 to produce lower financial results in the first half of 2019 as compared to 2018, as Ravin was filling stocking orders for its customers throughout the beginning of 2018. Importantly, as we have mentioned previously, when we acquired Ravin, we assumed this and underwrote a normalized level of sales when determining our valuation, essentially underwriting sell-through, not sell-in.

Finally, 5.11's first quarter revenue increased by 4.9% and EBITDA increased by 40.9% compared to 2018, exceeding our expectations. With the U.S. ERP implementation and warehouse expansion behind us, we remain optimistic about the prospects for 5.11 as we continue to drive operational efficiencies and to satisfy the changing needs of our core first responder and military customers and drive revenue growth through our consumer lifestyle product line.

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. Today, I will discuss our consolidated financial results for the quarter ended March 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-Q that was filed with the SEC yesterday.

I'd like to first highlight our efforts in continuing to improve our transparency of the company. Included in the press release we filed last night is a new format of our financial information. This is the same information that an investor can find in our 10-Q, but presented in a tabular format.

For example we've now included a table of net sales and EBITDA by subsidiary reconciled to our consolidated amounts. In addition, we've improved our presentation of CAD by including it as an operating measure and reconciling it from net income through EBITDA. This reconciliation provides important components of our CAD in a more efficient format. We will continue to present CAD as a liquidity measure and reconcile it to cash flow provided by operations. We believe this new press release format will provide our investors and analysts the information they need to assess our operating and liquidity performance in a more efficient and effective manner.

Turning to our results, on a consolidated basis, revenue for the quarter ended March 31, 2019 was $402.5 million, up 16.9%, compared to $344.4 million for the prior year period. This year-over-year increase reflects notable revenue growth at our Clean Earth subsidiary, increased revenue contributions from 5.11 Tactical, as well as contributions from our acquisitions of Foam Fabricators and Rimports in early 2018 and Ravin in the third quarter of 2018.

Net income for the quarter ended March 31, 2019 was $110.2 million as compared to a net loss of $1.6 million in the prior year quarter. During the first quarter of 2019, CODI recorded a gain on the sale of Manitoba Harvest of $121.7 million. Offsetting this gain was a loss on the sale of our Tilray shares of $5.3 million during the first quarter of 2019. We sold all of our Tilray shares we received at closing by quarter end.

Cash flow available for distribution or reinvestment, which we refer to as CAD, for the quarter ended March 31, 2019 was $17.6 million compared to $14 million in the prior year period. As Elias mentioned earlier, our Q1 CAD exceeded our expectations, in part as a result of better-than-expected subsidiary EBITDA growth and in part due to reduced capital expenditures and cash taxes.

As a reminder, our capital expenditures and cash taxes can vary greatly from quarter-to-quarter. And we anticipate the lower capital expenditures and cash taxes from the first quarter to be made up over the balance of the year. During the quarter, our CAD results were primarily impacted by our 2018 platform and add-on acquisitions, improving 5.11 operating performance offset by higher interest costs.

Moving to our balance sheet, we had approximately $39.8 million in cash and cash equivalents and net working capital of $455.1 million as of March 31, 2019. We also had $495 million outstanding on our term loan facility, $400 million outstanding in Senior Notes and $85 million in outstanding borrowings under our revolving credit facility.

We have no significant debt maturities until 2023 and had net borrowing availability of approximately $515 million under our revolving credit facility at March 31, 2019. At March 31, 2019, our leverage ratio was approximately 3.57 times down from 3.96 times at year-end.

Turning now to capital expenditures, during the first quarter of 2019, we incurred $5 million of maintenance capital expenditures, compared to $5.9 million in the prior year period. The decrease in maintenance CapEx was primarily related to lower spend at 5.11 Tactical.

During the first quarter, we continued to invest growth capital, spending $2.5 million primarily at our 5.11, Clean Earth and Foam Fabricators business. For the full year of 2019, we expect to incur maintenance CapEx of between $27 million and $32 million and anticipate growth CapEx spend of between $18 million and $23 million, as we continue to invest in the long-term growth of our subsidiaries. The largest share of our growth CapEx spend will be to support 5.11 long-term growth objectives.

As Elias mentioned earlier, we continue to anticipate our distribution payout ratio for the full year of 2019 to be between 75% and 95% assuming the same level of distributions in 2019 as in 2018.

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 pleased with our performance in the first quarter of 2019, delivering solid financial results that exceeded our expectations, and executing the sale of our Manitoba Harvest subsidiary.

Our balance sheet remained strong, and we enhanced our liquidity by repaying approximately $180 million of our revolver borrowings with the Manitoba Harvest proceeds. 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. Our acquisition efforts will continue to focus on accretive add-on opportunities and selective platform opportunities where we can acquire niche market leaders at valuations where we can expect to exceed our weighted average cost to capital. Further, we will continue to consider opportunistic divestitures in this market in line with our strategy of creating long-term shareholder value.

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 when appropriate, distributing sizable distributions and creating long-term shareholder value.

Finally, we will be hosting our 2019 Investor Conference in New York City on June 27. We are pleased to have 5.11 present at our conference this year. And with that operator, please open up the lines for questions and answers.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Kyle Joseph with Jefferies. Your line is open.

Kyle Joseph
Analyst, Jefferies LLC Q

Hey. Good morning, guys, and congratulations on a good start to the year and as well on the sale on Manitoba Harvest.

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

Thank you, Kyle. Good morning.

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

Thanks, Kyle.

Kyle Joseph
Analyst, Jefferies LLC Q

Good morning. Yeah. So on that note and given how you wrapped up the call with your commentary on middle-market multiples, can you just give us a high level sense of where you are in terms of being a net buyer versus a net seller? Given the Manitoba Harvest successful sale, are you considering any other potential sales at this point?

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

Yeah, Kyle. We don't disclose, as you know, if we're considering sales of assets or acquisitions of assets. That's been something historically we have not done and will choose not to do going forward. So we're not going to comment on that. I would say multiples continue to remain elevated. We are in a pretty conducive market.

Interest rates remain at really low levels. There's benefits, obviously, from the tax reform that improves cash flow, so that helps improve valuation multiples broadly. And then there's a kind of continued appetite from both strategic and private equity investors, just broadly in the marketplace. So I would say all of the – the confluence of all of those events continue to keep acquisition multiples at an elevated level.

I would say we're always open for business to find new opportunities to deploy capital. Our teams are looking aggressively for opportunities that are out there. But the big caveat is we have to be able to underwrite new opportunities and believe that we're going to exceed and hopefully, at a material level, what our weighted average cost of capital is. That's kind of harder to do in today's environment.

So if you said, are we more apt to over kind of the next year or so be a divester versus an investor, I would think that's probably more likely, just given kind of where the market's at. All that being said, we have nine platform companies that remain in the portfolio today and we're constantly looking for add-on acquisitions, and so, that can alter the equation.

Kyle Joseph
Analyst, Jefferies LLC

Q

That's very helpful. Thank you. And then balancing that, obviously, multiples remain high, but a lot of the folks we talk to are very concerned with where we are in the cycle. I would just say, given your portfolio of nine diverse companies, can you give us a sense for what you're seeing macroeconomically and any sort of signs of deterioration or is it economy sort of continue to chug along?

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

A

Yeah. So, it feels like the economy continues to chug along. We don't see anything right now that is from a macro level giving us major concern. I would say throughout our portfolio, especially within our industrial businesses, we get a sense of a lot of different parts of the economy.

The auto, for example, within Foam Fabricators, the autos part of our business was a little soft in Q1. I think there's been a lot of headline news about autos being relatively soft, we saw that. But some of the more economically sensitive sectors like appliances, for example, held in fine in the first quarter, and just broadly across the portfolio, especially with respect to our industrial businesses, we saw a pretty good stable operating environment. And so far in April, there's nothing that has deviated from what we saw in the first quarter.

So, overall, it feels okay. I would say some of the pressures that we saw last year on commodities and other input costs have definitely started to abate in 2019. And so, some of those inflationary cost pressures are no longer kind of a headwind for our earnings, and revenues feel kind of like they are tied to us and improve – not a improving but a stable economy.

Kyle Joseph
Analyst, Jefferies LLC

Q

Got it. And then, last one from me, just regarding potential C corp conversion, we've seen a few more alternatives take that route. Can you just update us on your thoughts there and the puts and takes you're evaluating?

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

A

Yeah. Sure, Kyle. We continue to assess that. We continue to assess it quarterly. Our board continues to look at it as well. We did see, of course, the big Blackstone move the past month or so. And it seems like it's been pretty positive for them. For us, we're a little bit of a different animal, given our tax structure and the way that our pass-through entity works.

So for us, the big hurdle continues to be where are corporate tax rates under a new – potentially a new presidential individual. So it's really dependent on that. I mean if you run the math today, it's kind of breakeven in terms of benefit if we were to move to the C corp. I think if we see a major increase in corporate tax rates over the next year or two, it's a negative and for us to move back to partnership would be very challenging. So we still – I think there is a lot of positives. I know you're aware of all of them. And it continues to be something we assess. We're not against it. But we need to make sure we have more clarity on the long-term view on some of the inputs to that analysis.

Kyle Joseph
Analyst, Jefferies LLC

Q

That's helpful. Thanks for answering my questions and congrats again on a good start to the year.

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

A

Thank you, Kyle.

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

A

Thanks, Kyle.

Operator: Our next question comes from the line of Larry Solow with CJS Securities. Your line is open.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Great. Thanks, guys. And Ryan, thanks to you and your team for the new streamlined press release, so very helpful there. Just a few questions on your – some of the bigger holdings. I think just on Sterno, I know you guys spoke to it a little bit but just a little bit of a slower start than I had thought and sounds like Q2 will be more due to timing than anything else, at least on Q2. So just any thoughts how Rimports is doing? I need little more color on that. And you mentioned that you still expect growth on the sort of full year, so it sounds like it's pretty much timing, but if you can give a little more color pm that, would be great.

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

A

Sure. So first on kind of the core Sterno, I wouldn't call the end markets in restaurants and food distributors kind of overly robust in Q1. It was fine.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

But any – the big sort of revenue shift, we had a project and a program that we mentioned that's in our home business that did anniversary. However, it anniversaried later in the year. It's a slightly different orientation, but it's basically very similar and it did anniversary, just anniversary more in Q3 and even perhaps a little in Q4 out of Q1 and Q2. So that's kind of on the topline. And then with regards to Rimports, it's solid, it continues to innovate in the space and we're very happy with the acquisition.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay. Great. Just on 5.11, great to see things sound like they're – the issues are in the past and you're sort of back to normal. And hopefully, the topline growth has never been an issue. So hopefully, we can just get the margin story back intact. I know last year, there was a little bit of – some impact from the timing of DTA. Has that bounced back or what's your expectation for that? And just I didn't go through the [ph] queue (00:27:57) yet but just how is sort of the retail growth trajectory going?

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

A

So, I'll go kind – this is Pat again. I'll go backwards first. First, on retail I'd say it continues to be solid. We don't disclose that but we continue to grow in retail both with new stores and kind of on the existing comping stores. So we're happy with that. As it relates to DTA, there really wasn't much DTA at all in these numbers nor do we expect too much in Q2. We could see some in the back half. So this is all sort of – and we believe we will see some in the back half. But this is all sort of non-DTA business that you're seeing here.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay. Great. And then just lastly, switching gears real fast just to Arnold, one of your smaller holdings of course, but you guys changed – I think you had a management change maybe a 1.5 year ago, 2 years ago. Just sort of what are your thoughts? I think it's maybe the one sort of – I won't call it a sore thumb, but maybe the one holding you have [ph] today (00:29:03) that hasn't probably done as great or lived up to expectations from when you first acquired it. So just any thoughts on when we might see that – become more of a needle mover over the next few years? Thanks.

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

A

Yeah. I would say, Larry, it's obviously one of our smaller businesses. But it's a company that given the repositioning, we have really a strong outlook for. The company is now focused primarily on the aerospace and defense end markets. It's an area where our technology can enable some of the forward technology that's occurring in both of those end markets. And I would say some of the programs that we are working on can be pretty material for the company's long-term growth rate.

So we think this is a really good well-positioned company. Clearly, it had some bumps along the way. And it didn't meet our original expectations on underwriting. But I think where we stand today and with the new team that we have in place and the end markets that we're going after, we think this could be one of our faster growing businesses over an extended period. So we're pretty bullish on the company. I would say like our other subsidiaries, we are looking for add-on opportunities. I think we'd like to get this business to be a more material company within our portfolio. And so that becomes a focus for ours.

But we're really pleased. And I would say the team that we have there under Dan Miller's leadership as CEO is doing an extraordinary job. And we obviously see what they're working on. I would say when you work in aerospace and defense, the good part of it is these programs become really long-term and they're very predictable.

The bad side of it is, it does take a little time to get spec down to kind of the new programs. And you really have to have a big funnel in order to kind of continually be moving projects through. We're in that stage right now where we've really been able to fill the funnel. And we're starting to see some real improvement in that business. So we're pretty excited about it.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Great. Thanks a lot. Appreciate that.

Operator: Thank you. [Operator Instructions] Our next question comes from the line of Robert Dodd with Raymond James. Your line is open.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Hi, guys. [indiscernible] (00:31:54) less a question about divestitures or not depending on market price and valuation and more your approach based on strategy. I mean if we look at the branded consumer, 5.11 obviously very successful. It controls its own distribution channel as well between online and opening the stores, et cetera, or controls the bulk of it, versus if we look at Liberty which continues to struggle because it's been reliant on brick-and-mortar retailers being the distribution, i.e., not controlling itself.

So is there any interest or focus on you guys to divest or adjust the businesses in the branded consumer based on whether you control the distribution – and we all know about the general problems in retail – or whether you're vulnerable to those general problems by distributing through a third party?

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

A

Yeah. Good morning, Robert.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Good morning.

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

A

I would say your high-level overview is correct, and it is a challenging environment with the changing retail landscape. I think as you've identified and very well publicized, that brick-and-mortar retail is struggling as more business moves online, and there are certain challenges within that, and different companies can navigate that better than others. I would say broadly, our view towards – let me start with – kind of as we look at new acquisitions, broadly, our view is as we look at branded consumer, the bar is just higher today because the risk profile is higher and different than what it was five years ago, let's say, in terms of the distribution channels that we're going through. And so we do need to find companies when we deploy capital more like 5.11 that control more of their destiny or have a distribution channel that we feel is consistent with where the markets are going forward.

In terms of the existing portfolio, you've identified with 5.11, I think that's a great opportunity, lots of white space, controls its own destiny. With respect to our other three branded consumer businesses, each one is addressing sort of the end markets that they go through, what the opportunities are, the changing landscape that we have. I would say we don't – again, we're not looking and saying okay, there is – we should be divesting this business or that, kind of we don't disclose that. However, I would say each of the companies are looking specifically in their markets and what the opportunities are and figuring out strategies to how to navigate it. But the overall bar whether it applies to new companies or as we look at our existing businesses for consumer today remains higher given the changing landscape that you've identified.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Got it. Thank you. I appreciate. Just kind of the other one, on CapEx, obviously maintenance, I think, you said was a little lower this quarter. I mean given that's a spend that you control – obviously things can move around, but was there a conscious decision to spend less on maintenance in some areas or just a random fluke of timing?

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

A

Yeah. No, there was no direction by us or our subsidiaries to reduce maintenance capital expenditures. The challenge with the way maintenance CapEx comes through financial statements is that a company might spend on a new manufacturing line in the first quarter with a cash outlay, but they don't put that line into service until the third quarter. When that line goes into service, can be difficult to predict. So that's when maintenance capital expenditures comes through cash flow and CAD. So it's not quite aligned with when they spend cash. So it's really the flow of when some of their CapEx gets spent and then put into service. That's really the challenge with maintenance CapEx.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Got it. I appreciate that. Thank you.

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

A

Sure, Robert.

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

A

Thank you.

Operator: And now, I'd like to turn the call back over to Elias Sabo for closing remarks.

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

I would 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.