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Compass Diversified Holdings, Inc. (CODI)

Q1 2020 Earnings Call

CORPORATE PARTICIPANTS

Matthew Berkowitz
Senior Account Executive, The IGB Group

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

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.

David P. Swanson
Partner & East Coast Managing Partner, 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 afternoon, and welcome to the Compass Diversified Holdings First Quarter 2020 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, The IGB Group

Thank you. And welcome to Compass Diversified Holdings first quarter 2020 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 Q1 2020 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-Q 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. 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-Q as filed with the Securities and Exchange Commission for the quarter ended March 31, 2020 as well as in other SEC filings.

In particular, the domestic and global economic environment is currently impacted by the COVID-19 pandemic, 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 afternoon. Thank you all for your time, and welcome to our first quarter earnings conference call. Before discussing our results, I'd like to take a moment to acknowledge the current unprecedented environment. The impact of the COVID-19 pandemic has been widespread around the world, and we are only just beginning to understand the near-term effect on our business. Today, I will describe what we are seeing at this time, the additional steps we've taken to position the company for long-term success, and further alignment, in addition to providing as much detail as I can about what we are expecting for the second quarter.

First and most importantly, the safety and well-being of our employees remains our top priority. We have implemented rigorous procedures at both the manager level and at our subsidiary companies to protect our employees such as working remotely when possible, strict social distancing measures when it's not, increasing cleansing protocols, temperature checking, and other best practices as suggested by the CDC. We will continue to take all steps necessary to protect our employees' health and ensure that they feel safe and supported.

Turning to the impact of COVID-19 on business. With over 90% of the US population under some form of shelter-in-place orders beginning in mid-March and continuing through most of April, US economic outlook suddenly dropped and dramatically dropped last month. European and Asian markets are under similar orders which have significantly impacted the global economy. As a result, our subsidiaries experienced a drop in demand for certain products beginning in mid-March and accelerating in April as the full effect of the shelter-in-place orders took hold. At CODI, we have always managed our business for the long-term and the unexpected. While the current situation may have been spent beyond our wildest streams last year, our hands-on and disciplined approach have positioned us defensively and will continue to be a distinguishing factor as we move forward.

We've worked tirelessly with our management teams over the last few months to reduce controllable costs and maximize cash flow at our subsidiaries. These moves include short-term actions to reduce labor costs, eliminate nonessential travel and reduce discretionary spending. We are hopeful that these measures are temporary as we work our way through the COVID-19 crisis and we have plans in place to restore our employee base and growth initiatives once the pandemic is behind us. We are also proud of how our subsidiary companies have responded to COVID-19 and congratulate 5.11 on its success supporting first responders as well as recognize the important work Sterno has done producing cotton masks and hand sanitizers for local hospitals and health care providers.

Despite the sudden shutdown of the global economy in March, we exceeded our financial expectations in Q1. During the first quarter we generated approximately $333 million of revenue, down 1.6% from the prior year's comparable period and $49.3 million of adjusted subsidiary EBITDA down 4.7% from prior year's comparable period. We generated $17.7 million of cash flow available for distribution and reinvestment which we refer to as CAD during the first quarter of 2020 exceeding our expectations and matching last year's CAD of $17.6 million. Ryan will discuss our financial results in greater detail shortly.

During the quarter we also announced our acquisition of Marucci Sports, which we closed on April 20. Marucci is the leading designer and manufacturer of premium baseball and softball equipment and apparel. Our permanent capital was a clear competitive advantage in sourcing this coveted consumer products business and moving forward with a platform investment at a time when pandemic fueled volatility that financial markets on wild swing and many others were unable to access funding. We are excited to welcome Marucci into the Compass family and are especially looking forward to working with Kurt Ainsworth, Marucci's Chief Executive Officer in positioning the company for success in the years to come.

Much like our prior subsidiary Fox Factory and 5.11 Marucci has created an aspirational brand by appealing to the top performers in its respected market. Over half of all big league baseball players use equipment by Marucci or its sister brand Victus. We see strong growth opportunities in continuing to take domestic market share entering into adjacent product categories and expanding internationally. While we're excited and encouraged by Marucci's long-term prospects we expect its financial performance in 2020 to be adversely impacted by the large scale suspension of sporting events, including Major League Baseball and all youth sports.

We anticipate Marucci will be roughly breakeven in EBITDA for our ownership period in 2020 with estimated EBITDA losses of roughly $1 million per month in the second quarter. Despite the anticipated reduced financial performance in 2020 and the expected losses in the second quarter, we believe that Marucci is a perfect fit for our consumer business and possesses the attributes that will result in market share growth and shareholder value creation in the long-term. While second quarter results probably will undoubtedly be impacted by the abrupt halt to large segments of the economy stemming from the global response to COVID-19, we believe we are well-positioned to effectively operate in a time of market dislocation and remain focused on taking decisive actions that will allow us to emerge even stronger from these unprecedented conditions.

Our group of subsidiary companies on a consolidated basis continue to produce positive cash flow and earnings thus far in April. We believe our branded consumer companies are largely poised to perform well in this environment, At 5.11, Velocity and Liberty all benefit from their readiness positioning. Further we believe that coming out of this crisis, these brands will appeal to a larger audience potentially positioning them for accelerated growth. Most of our industrial businesses are performing well considering the dramatic drop in global GDP. However, Sterno has faced some challenges. Sterno's core catering line has seen a dramatic reduction in demand as large gatherings and catered events are prohibited throughout most of the United States. Pat will discuss the trends in our consumer and industrial businesses further.

Turning to guidance, in light of the current economic uncertainty, we are withdrawing our guidance for 2020. However for our second quarter of 2020, we currently anticipate pro forma adjusted consolidated subsidiary EBITDA of between $28 million and $38 million, a reduction of 30% to 50% compared to the second quarter of 2019 excluding Marucci.

Due to the reduction in Q2 earnings expectation, the manager has decided to waive 50% of its management fee in the second quarter, and our Board of Directors has agreed to waive 50% of its cash payment due for the second quarter.

Although Compass has very strong liquidity and our earnings are holding up comparatively well. The board and manager felt it was appropriate to reduce our compensation levels to align ourselves fully with our shareholders. Additionally, the manager has decided to defer any payments it would be entitled to receive under any five year anniversary incentive payment for all of 2020. We expect these moves to save the company approximately $10 million in cash flow in 2020, and offset some of the challenges I had.

Before turning the call over to Pat, I want to emphasize that we are in a strong liquidity position due to the strategic moves we made last year. As many of you know prior to Marucci, we had not consummated any new platform or add on acquisitions since February 2018 and September 2018, respectively. We have often stated that asset prices were at historically high levels fueled by an abundance of debt and equity capital that we were very long in the economic cycle and that high prices being paid for assets resulted in returns that were below our weighted average cost to capital.

With this in mind, we not only remain disciplined in our capital deployment, but we also went one step further and divested two businesses at very attractive valuations and issued $115 million of preferred stock in order to repay all of our revolver and term loan indebtedness and sit on cash. These strategic decisions allowed us to defensively position the company. And while we knew we would under-earn our balance sheet potential in the short-term, we felt it would be appropriate to balance risk and return.

As you will recall, manager voluntarily waived management fees of approximately $10 million starting in the second quarter last year in a move that aligned our interest with our shareholders much like the moves we announced today. These decisions to defensively position ourselves last year when others were aggressively accumulating assets has served us well. Not only do we believe we have the liquidity to meet the needs of our subsidiary companies, but we're able also to acquire an outstanding business in Marucci during the midst of this crisis and meet our capital allocation needs by declaring distributions on our Series A, B and C preferred shares and our common shares.

With that, I will now turn the call over to Pat to provide additional detail on our subsidiary company's performance in the first quarter.

Patrick A. Maciariello

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

Thanks, Elias. I'll begin with our niche industrial businesses. For the first quarter of 2020, revenues declined by 7% and EBITDA decreased by 10.5% over the comparable quarter in 2019. Advanced Circuits was down 10% in Q1 2020 from the year-ago period. Advanced Circuits EBITDA declines improved sequentially in each month during the first quarter, with March roughly meeting 2019 performance. Thus far in April, Advanced Circuits is performing roughly in line with last year.

Foam Fabricators EBITDA was down 3% in Q1 2020 from the year-ago period. Foam Fabricators is benefiting from lower input costs and other cost containment initiatives. In addition, Foam Fabricators are seeing increased demand for insulated coolers, which are using food delivery and pharmaceutical shipments among others. Thus far in April, Foam Fabricators is seeing significantly reduced demand as a result of a reduction in revenue from its appliance customers. However, cost containment measures and lower input costs are expected to somewhat mitigate the effect on earnings.

Arnold Magnetics EBITDA was up 7% in Q1 2020 from the year ago period. Arnold benefited from increased bookings in the back half of 2019 that were scheduled to ship in 2020. We expect these 2019 bookings to continue to benefit Arnold in the second quarter. However its book-to-bill ratio started to decline in February and it's fallen below 1 at the end of March.

The Sterno Group's EBITDA was down 19% in Q1 2020 from the year ago-period. Sterno was performing ahead of expectations in January and February. However as Elias mentioned, demand for its core catering products fell dramatically at the end of the first quarter. We expect the catering and related products business to experience extremely weak demand in the second quarter and weak performance for at least the remainder of the year. As a result, we make cost cuts in order to right-size the business during this unprecedented time.

We've also experienced weakness in Sterno's Home division, and took actions to substantially reduce fixed costs in the business in early April. Despite the reduced performance of Sterno Home, the Consumer division of Sterno Group is performing well as our line of wax products and essential oils, which are essentially sold to big-box retailers have outperformed the expectations. Historically the consumer portion of Sterno's business has represented roughly 60% of its EBITDA and we expected to be flat or improved slightly on a year-over-year basis. We expect the foodservice business however which historically has been 40% of our EBITDA to be roughly breakeven for the remainder of 2020.

Now turning to our branded consumer businesses. For the first quarter of 2020, revenues and EBITDA increased by 4.2% and 4.3%, respectively, over the comparable quarter in 2019. Ergobaby's was down 30% in Q1 2020 from the year-ago period. Ergobaby has a global footprint and drives the majority of its revenues internationally. So, it experienced significantly reduced demand in Asian and European markets in Q1. These negative trends of accelerating in April, and we expect Ergobaby to experience significantly lower demand in all of its markets while its wholesale brick-and-mortar customers remain closed.

Domestically, Ergobaby have a strong and growing digital presence to offset some of the declines. Ergobaby demand has historically been tied to global birthrates and less impacted by economic conditions. Therefore we believe Ergobaby is poised for a strong rebound in operating results later in 2020 as brick-and-mortar retail customers reopen their doors.

Liberty Safe's EBITDA was up 66% in Q1 2020 from the year-ago period. Liberty Safe secured distribution with a large farm and fleet customer in mid-2019 that is benefiting the first half of 2020. Liberty's products remain in high demand given the current level of uncertainty, however many of the brick-and-mortar stores closed in April negatively impacting performance. Despite the store-closures, Liberty continued to experience solid demand and as expected to outperform Q2 of last year.

Velocity Outdoor's, EBITDA was down 28% in Q1 2020 from the year-ago period. This performance is better than expected its demand for airgun products accelerated in March. As a reminder, we embark on a restructuring on this business in mid-2019 and expected financial headwinds through a most of 2020 as a result of the restructuring. The restructuring efforts are proceeding as planned and the management team under Kelly Grindle and Tom McGann's leadership is performing extraordinarily well. April trends for this business to continue to be very positive on the airgun side.

5.11's EBITDA was up 27% in Q1 2020 from the year ago period. 5.11 continues to perform ahead of our expectations. Starting in late March, 5.11 closed most of its retail stores to consumer customers. 5.11's products were integral to first responders in fighting this pandemic. So its retail stores remain open to those essential workers. However to protect our first responders and employees, 5.11 closed store access to the general public. As a result, retail channel sales numbers have been significantly impacted. However, 5.11 is a digitally focused brand and they've experienced increased demand for its products at its e-commerce site, which is up over 100%

thus far in April from a year ago period. Further, revenue in its direct channels of 5.11Tactical.com and its retail stores are up mid-single digits on a month-to-month basis over the prior year, demonstrating the strength of 5.11 as a consumer lifestyle brand. Despite the improvement in its direct channels, 5.11 consolidated revenues are trending down thus far in April in the high single digits from the prior year.

5.11 has moved rapidly to cut cost to align the expected temporary demand drop. However, it will continue to invest in certain growth initiatives that enhance consumer experiences and accelerate its digital efforts. We continue to believe that 5.11 is positioned to emerge from this crisis stronger than before as consumers adopt a preparedness mindset, consistent with 5.11's mission statement to always be ready. We continue to believe 5.11 will be transformational to the entirety of Compass.

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 first quarter of 2020, I want to highlight our first quarter distributions that were recently paid to shareholders. Last week on April 23, we paid shareholders a cash distribution of $0.36 per common share, representing a current yield of approximately 7.2%. Including this distribution, we have paid approximately $19.32 per share in cumulative distributions since CODI's 2006 IPO. This reflects 129% of the IPO price. In addition, today, we paid cash distributions of approximately $0.45 per share on our 7.250% Series A Preferred Shares and approximately $0.49 per share on our 7.875% Series B and Series C Preferred Shares. All three preferred distributions cover the period from and including January 30, 2020 up to, but excluding April 30, 2020.

Moving to our consolidated financial results for the quarter ended March 31, 2020, 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 earlier today. On a consolidated basis, revenue for the quarter ended March 31, 2020 with $333.4 million, down 1.6% compared to $338.9 million for the prior year period. This year year-over-year decrease reflects the challenging economic conditions as a result of the COVID-19. Strong sales growth at our branded consumer subsidiaries 5.11 and Liberty was offset by declines in our other businesses previously discussed.

Consolidated net income for the quarter ended March 31, 2020 was $4.9 million. Consolidated net income for the prior years' first quarter was $110.2 million and included a $121.7 million gain recorded in connection with the sale of Manitoba Harvest. CAD for the quarter ended March 31, 2020 was $17.7 million essentially flat from the prior year period. Our CAD during the quarter was above our expectations with EBITDA down slightly from prior year and cash taxes roughly in line with our expectations, the primary driver of our CAD outperformance was the direct actions taken by our subsidiary management teams reducing CapEx spend in March as a result of the economic conditions.

The other factors impacting our CAD during the quarter as compared to prior year was lower interest expense and management fees, an increase in preferred share distributions as a result of our Series C issuance in November 2019 and the loss of cash flow from our two divestitures in the first half of 2013. A highlight of our quarterly performance was our ability to generate a slight 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 and the substantial impact of the pandemic on the global economy beginning late in the first quarter.

As previously discussed, we anticipate a challenging second quarter in earnings for our subsidiaries. The lower expected earnings will have a direct impact on our second quarter cash flow generation. As Elias mentioned, we have directed our management teams to reduce CapEx spend and preserve capital during this challenging time period. Subsequent to the acquisition of Marucci the recent payment of common and preferred share distributions and the recent payments of interest, we estimate cash balances today at CODI and our subsidiaries totals between $55 million and $60 million. In addition, we have approximately $400 million available on our revolver and liquidity.

We anticipate that this cash and the revolver availability will provide our companies with a financial flexibility and liquidity they'll need in the short and intermediate term. Pro forma for the acquisition of Marucci, we estimate our leverage at just over 2 times. Our balance sheet is strong and we stand ready and able to provide our subsidiaries the financial support they need as well as move on compelling investment opportunities in this dislocated market should they present themselves.

In addition to the impact of our lower second quarter expected cash flow Clean Earth divested in June of last year produced a significant amount of CAD in the first half of last year as it paid 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 2019, the loss of Clean Earth cash flow will produce negative comparisons in CAD.

Turning now to capital expenditures, during the first quarter of 2020, we incurred $3.3 million of maintenance capital expenditures of our existing businesses compared to $3.6 million in the prior year period. The decrease in maintenance CapEx was related to reduced CapEx spend across the majority of our businesses. During the first quarter of 2020, we continue to invest growth capital, primarily in January and February, spending $3.3 million in the quarter, primarily related to 5.11's long-term growth objectives. Growth CapEx in the prior year quarter was $2.5 million.

Turning to our expectations for 2020, 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 factors such as the timing of shipments of large orders or the timing of certain investments made before or after quarter-end.

As Elias mentioned, we are withdrawing our previous full year 2020 EBITDA and payout ratio guidance range. With the amount of uncertainty many of our subsidiaries are facing, we are unable to provide the revised range of full year 2020 EBITDA today. To the extent we have clarity on our next earnings call, we will provide a revised range then.

For maintenance CapEx, we had previously estimated CapEx spend of between $20 million and 25 million for the full year of 2020. Our current estimate for maintenance CapEx for the full year of 2020, including Marucci is between $13 million and $16 million. For growth CapEx, we had previously estimated spend of between $10 million and $15 million for the full year of 2020. However, our revised expectation for growth CapEx is between $6 million and $10 million, primarily at 5.11. A majority of this growth CapEx spend is expected in the first half of the year as 5.11 builds out store fronts for leases entered into prior to the pandemic, and for IT systems to enhance consumer experiences across their numerous channels. For 2020 cash taxes, our expectations were to spend between 6% and 8% of our subsidiaries total EBITDA on cash taxes. However as a result of the expected decline in taxable income at certain of our companies, we expect cash tax payments will decline. Given our inability to provide an EBITDA guidance range for full year 2020, we are also unable to provide a range for cash taxes. As with EBITDA, we hope to provide a revised range on our next earnings call.

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. I would like to close by briefly discussing M&A activity and our forward growth strategy. As I mentioned earlier, we took steps in 2019 to prepare for the unexpected. Those decisions have positioned us well to make it through this crisis and emerge as a stronger company on the other side. We continue to believe our hands on and disciplined approach has and will continue to set us apart and ensure our portfolio is well-situated to weather the storm. We are taking deliberate near-term actions to further align interests with shareholders, which will better position us to deliver meaningful value in the years to come.

As we have done through other challenging moments in time, we are confident that we have the right strategy, an excellent team in place and a strong group of subsidiaries to not only preserve, but also find stronger footing on the other side. As difficult as we expect the second quarter to be, we believe that the companies that successfully manage through this turmoil will be stronger and more valuable moving forward. We have the balance sheet strength to support our companies as they operate in these highly unusual times. Our companies our market share leaders in their respective niches and are poised to gain additional market share. Our balance sheet strength has allowed us to pursue growth initiatives unavailable to others as the debt markets close to all but the highest quality issuers. We believe the best opportunity to generate long-term shareholder value occurs by acquiring premium assets during market dislocations like we are currently experiencing.

While we will always prioritize the financial health of the company over strategic acquisition and this time will be no different. We are constantly evaluating the best ways to enhance our portfolio. We entered the year with significant balance sheet strength and will seek to capitalize on select opportunities while maintaining a balanced approach to risk taking. Our strategy remains the same going forward. We are intensely focused on executing our proven and disciplined acquisition strategy, improving the operating performance of our companies, opportunistically divesting, enhancing our commitment to ESG initiatives across our portfolio, distributing sizable distribution, and creating long-term shareholder value.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And our first question coming from the line of Kyle Joseph with Jefferies. Your line is now open.

Kyle Joseph
Analyst, Jefferies LLC
Q

Hey. Good afternoon, guys. Let me start by saying we appreciate the guidance, it's hard enough to model one company in this environment, let alone 9, so much appreciated there. You know I wanted to start off on 5.11. If we could – I mean give us a sense for the breakdown of sales between stores and online. And then just based on the geographic dispersion of stores, give a sense for the outlook of store reopening.

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

Sure. Good afternoon, Kyle. It's Elias. First I would say between our e-com and retailing, as we said in our script, the e-com and our retail business when you combine the two is running up sort of high single-digits over last year, which to be honest with you we think is just an incredible achievement considering the condition. Our retail stores are running down a little more than 50% right now month to-date in April. It's a little too early to tell on reopening how those will trend. So we don't have anything on geographic dispersion yet to share with you. As reopening happens, we are looking at states where reopening is occurring more quickly, take Georgia or Texas, and we are looking at how the stores build and I think that will help inform us in states that reopen more slowly like California. So we're accumulating that data right now, too early to tell.

Our e-comm business is running well over 100% up year-over-year. And so what really encourages as we've seen you know 5.11's results is as our retail has closed to the consumer, that consumer has moved over by and large to our e-comm site. And kind of year-over-year demand for the product and what arguably is the most unusual time in our lifetime is actually up. So I think it bodes really well for how strong this brand is and how strong this brand will emerge.

Kyle Joseph
Analyst, Jefferies LLC
Q

That's really helpful. Thanks. And full disclosure here, I haven't read every single word of the CARES Act, but do you have any scenarios that would have been eligible for PPP?

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

Yeah. I'll ask Pat to answer that.

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

Yeah, I mean holistically with the government initiatives, we have not, you could quest, you know there's some affiliation rules that make us or we felt it wasn't the right thing to do to apply for the PPP. The only real sort of recovery act that we participated in and it was ever so slightly was the Families First Coronaviruses Relief Act which as you know, if an individual employee in a company of less than 500 people, which is in all our companies which is just some of our companies have to take a couple of weeks off if they have a family member who's sick or something like that we get an offset for that salary [ph] and tax credit for payroll taxes (00:33:41). I haven't really seen the numbers on where we've used that. If we have used that it's been very, very sparingly and that's sort of the only Recovery Act sort of statements that we have taken or will take it.

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

A

And Kyle, let me just add one point to that. I think the PPP plan and we're seeing some backlash to public companies that have access to capital that are taking it. I think that was designed more for smaller, private health companies that don't have access to capital. Our liquidity is awesome to be honest with you and we feel that the earnings power of our company is on a comparative basis holding up extremely well. And so, we wouldn't feel morally that it is correct for us to apply for these programs that are designed for companies that need it and need it just to keep people on their payroll. And so, we have adequate capital, we have adequate resources to be able to make it through. Our companies are positioned really well in performing to be honest with you much better than our expectations, if you had asked us four or five weeks ago. And so, we don't feel that it would have been morally right to accept those payments even if we were eligible.

Kyle Joseph
Analyst, Jefferies LLC

Q

That's a great answer and I think everyone can get behind it. Next, I'll ask Ryan a question just on the balance sheet, given rate movements in the quarter, can you give us a sense for your cost of funds? Obviously, given your fixed versus floating liabilities and just remind us if you have any [indiscernible] (00:35:29) and any of those facilities, and then address potential refi opportunities with lower rates, versus wider spreads?

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

A

Sure, Kyle. Good afternoon. So, as you recall because of the substantial sales we had in 2019, we entered the year with really no floating rate, our revolver was zero, our term loans were paid off and the only debt we had outstanding was our bond at $400 million, which is a fixed rate instrument. So, now that we've closed on Marucci last week, we've we have or took $200 million down on the revolver for that acquisition that today you know is a LIBOR plus a spread instrument. Our spread today on that LIBOR is $175 million and there is no LIBOR for in that agreement today. So, we think our floating rate today are variable, interest rates are quite low. So we don't see you know a reason to refi today. Is that, is that helpful?

Kyle Joseph
Analyst, Jefferies LLC

Q

Yes. That's great. And then a last one. I was trying to write down everything you said on the call, but I missed some of your commentary on the pipeline in terms of potential acquisitions given the market disruptions here. Can you just walk us through how did the pipeline look in mid-March when volatility started in early April and volatility really peaked in and then subsequent to the equity market recovery, how the deal flow has really changed this, over the last call it, 60-days.

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

A

Sure. So Kyle, first to say and I just want to emphasize that we view the Marucci acquisition as being a direct result of the market dislocation. This is a really highly coveted asset in I think as you guys see this business in its performance over the years and sort of how it was trending. This is a business that came to us by virtue of the fact that COVID had a major impact on financial markets broadly and M&A was shutting down and it gave us a huge leg off. So I only say that because it really is illustrative of how we can use our balance sheet strength right now and our permanent capital model has a massive advantage when others mainly PE are sort of frozen out of the market unless they want to equitize the whole thing because availability of debt to finance standalone acquisition today is near zero.

So with that said in mid-March I would say the pipeline was pretty robust. We saw – and in our pipeline I would say over the course of 2019 and coming into this year was really robust. What we kept saying was pricing is just outside of kind of the range at which we would be willing to transact. Starting in mid-March, I would say there's been a complete freeze in all M&A related activity and that's gone on for the last 45 days. There are some companies that we have had reach out to us that we had been talking to where it is pretty much desperate times, they may be working in highly impacted industries and are just trying to figure out how to get to the other side. I think there's still right now a relatively large win M&A markets reopen, relatively large bid out spread. I think as with capital on the buyer side, view prices that needs to come down pretty dramatically. But as I've heard people say asset prices are sort of sticking on the downside. And so sellers are reluctant to, I think right now, come to grips with the reduction and valuation, that will absolutely change as markets ort of come back, and as we get more price discovery in the next sort of 60 days to 90 days.

So we would anticipate that we'll be reengaging on assets that we think are strategic and provide really good upside to our shareholders, we'll reengage with asset value – at valuations frankly that we think are highly opportunistic. And I'll make one other point Kyle, I think that for our investors and analysts that is meaningful, in this time of dislocation right now, we see a real unique time. The public markets have come back in much more of a V-shaped recovery. I think we've recovered most – 60% or something of the losses that we had experienced at our highest point in March. Private markets don't react that quickly and places don't fall that quickly, but they also don't react back that quickly. And so as prices in the public market come back and for insurers like ourselves, who have been our stock come back, our bonds trading back above par, our preferred trading back towards par, there is an arbitrage that starts to exits where we're starting to perform much better in our security, but the private market and the buyers who would be competing are still frozen out of markets. And we think that create sort of the ideal condition for us to be able to reach active and create value for the long-term for our shareholders.

So this is frankly what we've been waiting for. None of us wanted a pandemic. Let me just start with that, and the health issues around this are absolutely atrocious, plus I think the cooling of the assets prices due to reduced economic activity was something that we were worked, we needed frankly given the size of our balance sheet and the strength that we had and the inability to find out that's to put money to work in. And so although we hate the reason that asset prices are coming down due to a health pandemic, we do think that it is very much beneficial for how we are executing our strategy right now.

Kyle Joseph
Analyst, Jefferies LLC

Q

That's all, very helpful. Thank you guys all for answering my questions, really appreciate it.

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

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Great. Good afternoon, guys. Good to hear your voices and I hope you and your families too are all relatively healthy [indiscernible] (0042:33).

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

A

Thank you, Larry.

[indiscernible] (00:42:36)

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

A

Thanks Larry.

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

A

Great. Thanks. Absolutely.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Sticking with sort of the acquisition team. Could you give us maybe just a little more color obviously just closed on Marucci. And I think this is your first public call since you acquired – announced the acquisition. Maybe discuss the strategy or sort of what you guys hope to help you know bring to cable to sort of – and the company is obviously pretty rapidly in the last few years. So maybe what do you think sort of Compass brings the table, what sort of the post corona outlook if you will?

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

A

Yeah Larry let me start and then I'll ask Pat and Dave to chip in as ask Pat indeed to chip in as those guys are the ones that kind of did all the heavy-lifting here. I would say, with respect to Marucci, it is our belief that these kind of assets don't come along that often. And we've seen it over history, I would say that this company looks most like Fox Factory in terms of the people that are at the top of the sport, are using it and winning with the products. Same sort of dynamic exists with Marucci, and that creates a halo in this aspirational pool that moves down into the broader part of the market for youth sport or for Fox for example with the Weekend Warrior. And so, to us this has the similar attributes and again these kind of companies don't come along all that often, which is why we have so much enthusiasm notwithstanding the fact that youth sports and baseball is on temporary pause right now in 2020.

So I'll start with that, but then I'll ask Pat and Dave to pitch in on sort of what we see as growth opportunities and how we see them being able to help them. Pat?

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

A

Yeah. I mean, I would just say you know it's a company that has a tremendous brand that we've been following for years, that is an underpenetrated internationally as well. I'd say there's been great strong solid trends in baseball participation over the last several years prior obviously to COVID. And lastly, I think the company was thrilled with the management team right now. We think the entire management team is very strong. We think they are strong leaders and we think there's a lot of markets here that can be gained both internationally and through new products that they have introduced or will introduce. Dave, what else would you add?

David P. Swanson
Partner & East Coast Managing Partner, Compass Diversified Holdings, Inc.

A

No, I think you hit on most of it. It starts with kind of the authentic enthusiast brand, a great management team and we feel like those – some good wide space to attack over time [indiscernible] (00:45:35) time, but in product extensions and other, in other baseball categories in softball, in international direct to team. So a lot of white space to attack over time starting with the authentic enthusiast brand.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right. Okay. So no CAD 9 this year though I guess? [indiscernible] (00:45:58) Just switching gears. On Sterno, just can you clarify that, the 60% of the business is so – is consumer, basically that's [indiscernible] (00:46:12) side and then the remaining 40% is Sterno heat and the home, is that right or am I getting those numbers a little mixed?

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

A

That's roughly correct.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay. Okay. So the [indiscernible] (00:46:25) side is doing okay. The heat side obviously is going really, not many [indiscernible] (00:46:30)

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

A

Service. Right, the foodservice division obviously is the one we talked to that's highly impacted. In totality, the rest of the business is solid with some areas of strength and some areas of weakness, but [indiscernible] (00:46:43) we gave you.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Okay. And then just, just on the cost cutting side and just we can just do it with a sort of broad brush. I get, I'm sure different at each of your subsidiaries in terms of where you can cut cost and you guys obviously run three lean operations as is. So are these kind of things more like work furloughs or slowing the shift. Well, obviously you don't want – you want to keep yourself well-oiled up for the long term. So I imagine most of the stuff I you can roll back when you have to.

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

A

Yeah, I would say Larry what we try to do and it's got to be a case-by-case example. So some of our portfolio is growing, growing pretty rapidly right like Liberty Safe and...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

...Velocity, those businesses are doing really well and we've got like Advanced Circuits and for right now 5.11 have been growing. So we have...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

...a lot of the portfolio that is growing and the parts of it that are growing in Q2, we're very careful not to take cost out unnecessarily because that could impact the growth opportunity. In the parts of the business that are flat or not growing, I would say it really runs the gamut. It can be anything from furloughing employees and layoffs, which frankly are the hardest for us to do emotionally, but necessary is cutting things that you would expect like travel expenses and conferences, those are easy because nobody is doing them. There is marketing expenses...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

...that are getting pulled back. Clearly CapEx has been...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

...brought down to essential levels. So I would say what we have instructed all of our companies and we really move very quickly in March as we saw this unfolding is real quickly.

If there's growth initiatives right now, we just have to be very careful and skeptical that with a GDP that's likely to be down, I think the consensus forecast is like 35% or 36% in Q2. We all need to be really...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Yeah.

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

A

...careful coming in to how the second quarter is going to look and therefore let's take decisive actions now but understand number one, we don't want to cut into muscles because we want to be able to have these businesses all not only performed through these times, but be able to service our customers well and frankly, take market share on the backside. And I think unfortunately there's going to be a lot of companies that are exiting the market via bankruptcies and closing down and the players that remain are all going to emerge stronger and their market share will [indiscernible] (00:49:38) typically in downturns and this is the biggest downturn of our life.

So, we've reminded our company that we need to be able to spool back up and to put all of our employees back and put all of our spending programs back as the economy comes back and as some of that market share as we think will naturally inure to us, we need to be in a position to take it. And I would say we've tried to maintain the point of attack spending across our portfolio. So, where we have had...

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Right.

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

A

...the least costs have come in sales, marketing and R&D, new product development because we think those are the things that will allow us to be aggressive market share grabbers here, but everything outside of that, we're in big cost containment mode and it's sort of the same playbook we ran in 2009 when we were during the financial crisis.

Larry S. Solow
Analyst, CJS Securities, Inc.

Q

Got it. Okay. Great. I appreciate it. Thanks, again for that.

Operator: [Operator Instructions] And our next question is coming from the line of Robert Dodd with Raymond James. Your line is now open.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Hi, guys, and I hope everybody's doing well. Just a follow-up – well and then some others, but I would say follow-up to Larry's question. On the cost cutting, can you give us any rough scale of, say where FTEs were, say ended the year? I mean, obviously the seasonality in it and where head count in general is today? I mean, I'm not looking for a company-by-company counts, but can you give us a kind of a little bit of context for just how significant that that cost cuttings that has been?

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

A

Yeah. Robert, that's probably a little bit more granular than what we would like to get into. I would say we expect if you want to know kind of in dollar terms, we expect millions per month in cost containment initiatives to be rolling through. So, like a 5.11 is going to have some pretty significant cost cuts that they've implemented as has Sterno and so it's millions and millions of dollars per month. But we're really not prepared to say kind of on FTE. Some of it is furloughed employees versus laid off. So, it's a little too early I think to start to disclose some of them.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Okay. Fair enough. Just looking at I mean the couple of businesses as you've said, I mean 5.11 in some elements is doing quite well, Liberty doing quite well in some areas. I mean, as [indiscernible] (00:52:41) is I think to ask this I mean how's the supply chain to those because obviously I mean 5.11 does a lot of manufacturing overseas and there's supply chain disruptions over there, so for the products that are selling well, what's your inventory situation, price change situation? Yeah, I mean how long you it can go – this disruption go on and the inventory situation remain okay in the product areas across those businesses that are selling well in this environment.

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

So, I don't want to say there is no issues, but there is – but our management team is working through them at each company very well. It's geography by geography, China goes down, China comes back up, Vietnam has stayed up, Bangladesh went down, but now is starting – I mean it's geography by geography. Broadly I would say, it's not our biggest concern right now. Our management team is nimble. They've sourced in multiple geographies throughout – company by company. So as of yet, it's not – there is other issues that we went through that we're far more worried about demand right now, Robert.

Robert Dodd
Analyst, Raymond James & Associates, Inc.
Q

Right. That's fair enough. On the liquidity situation, obviously you call it $60 million in cash, $400 million available under revolver, you were 2.5 times leverage on kind of trailing EBITDA. Obviously EBITDA is going to fall, and will lower trailing. I mean how much – but at the same time, maybe the opportunity set is improving. You've talked about you having the pipeline and maybe share being available to pick up, some of that could be organic, some of that could obviously be acquisitive. Where is this environment, would you be willing to take leverage? And how much of that liquidity would you be willing to utilize on an acquisition front versus a reserve obviously in case portfolio companies need additional support?

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

Sure. So I'll just start, Robert, high level and then I'll ask Ryan to also chip in. As you said our leverage is I think a little over two times right now. Ryan, correct me if I'm wrong. It will increase. We've obviously guided to kind of down 30% to 50% in the second quarter and I would say frankly April is tracking a little better than expected, and so we plan – I would say we feel really good about that range and hopefully even improving beyond that. But undoubtedly leverage is going to come up because the denominator in that calculation is coming down. So we still think when we stress test our companies that our leverage is below sort of high end of the target band that we've talked about publicly, and so that provides some availability to be out there. In terms of liquidity, we look at it right now as we have $400 million available on our revolver, but we have a $250 million upside option should we go out and choose to exercise that. And our senior leverage is kind of one-time. So I would hope our lending partners are excited about providing to a low risk credit like us.

And frankly know we view sort of the debt capital markets as being pretty wide open. As of yesterday, I think we're trading [ph] $1.03 (00:56:41) on our bond. And so the bond market is pretty strong. So I think for us we have access to the capital markets that would allow us to increase the amount of availability, but obviously we need to work within our leverage covenants. I think as we get three, six months from now and we have a better understanding of earnings trajectory broadly not just with us, but probably in the economy, then we could be a little bit more acquisitive and be willing to bring our leverage up to kind of the high part of our desired range, and potentially even a little bit above that temporarily. But it would be temporary because we believe, we are deleveraging pretty quickly.

Ryan, what would you add to that? You're obviously working with our capital markets providers all the time?

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

Yeah, sure. So a lot of – everything you've said, Elias I've agreed with. Just to add some clarity to the numbers, we are a little over two times today as I mentioned in the prepared remarks pro forma for Marucci and Robert, as a reminder, we have total debt covenant capacity of five times. So, we have a what – we think we're extremely comfortable with our covenant position even with the expected declines in EBITDA and even if we stress test those. Okay.

In terms of where we are prioritizing our liquidity today, we've touched on a couple of these, but I will reiterate because I think it's important. One, first and foremost, it's to support our companies through this unprecedented time. We want to ensure that they emerge even stronger. We talked about in their niche markets as they're a market share leader. If they come out of this, they should have greater market share and we want to make sure our companies have the financial support to get there.

Number two is, we will use our liquidity and prioritize our capital allocation, which includes our distributions on our preferred and common. Okay. Third, only after the first and the second have been satisfied, will we in, as Elias said, three to six months from now, would be able to think about finding and investing opportunistically. And in terms of capital, it's I think in our minds finding some add-ons to existing companies is a great potential use of capital in this, near to intermediate term in that three to six months period.

For us today thinking about a substantially large platform deal in the next three to six months is very low likelihood, just given the uncertainty in the markets and uncertainty in cash flow streams, valuations, et cetera. So, I think that's, that's really how we're thinking about it, hope that gives you a decent framework about our liquidity and how we prioritize that capital.

Robert Dodd
Analyst, Raymond James & Associates, Inc.
Q

Absolutely. I appreciate that color. Yeah. Understood. Elias, I've got to ask a follow-up since you mentioned it, April tracking slightly better than expected. So, can you be any more than you can say about that, is that particular areas, is that the good businesses doing even better or is there, are there some surprises in there that is something you thought might be a bit weaker is actually doing better? Any, any color on that one...

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

Yeah. I would...

Robert Dodd
Analyst, Raymond James & Associates, Inc.
Q

...since you opened the door a little bit?

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

Sure. No. I appreciate that. I mean as we've been looking at this, since we thought, yeah, I'll step back and say, I think all of us in business have viewed the orders to stay at home and just being so outside of the realm of what we could ever imagine, that you probably – we probably all have some dark thoughts to go through our mind with respect to how that's going to impact our company and how do you operate and how is human behavior going to happen. And so I think it was as we started to see these rollout, it was a scary time, Robert, to be honest. And I think as every week has gone by, we've seen our companies doing, I would say not across the board, but the majority of our companies are doing substantially better than what we would have thought as early as late March.

And this is a very dynamic market where things are moving really quickly. And so, as we put together, here's what our Q2 forecast looks really company by company and working with our subsidiaries and understanding, what are their order flows coming in, what's their backlog look like, what cost cuts that they're taking out. I would say a few of our companies are performing frankly a little better than what we saw. If you ask I would say 5.11 is one of those categories, it really gets into kind of the companies with the readiness positioning. So 5.11, Velocity, Liberty, their performance is holding up much better than what we would have thought.

But on the other side, I'll tell you in our industrial portfolio, I look at a company like ACI which is – or it's by far shortest cycle business, very little backlog. Everything comes in sort of today, it gets produced tomorrow, you know three days from now, four days from now and we're seeing their orders hold off and as Pat mentioned they're kind of holding up comparable to a year ago period. And so that is surprising to us. We would have bought a few weeks ago, short-cycle business, shut down of the economy, that's going to be impact it quite severely and to see it holding up as well as it is, frankly is really encouraging. So it is not all eight companies, now nine with Marucci. But we have some really good bright spots within the portfolio, and pretty much everybody is sort of holding their own. And so, we're encouraged by it. Pat, do you have any follow-up?

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

A

I'd just add our management teams broadly have been very nimble and shown a great deal of scale at the subsidiary level. We always had high expectations of them and know that we are fortunate to work with great people. But they've performed very well, and are continuing to perform very well broadly in this environment.

Robert Dodd
Analyst, Raymond James & Associates, Inc.

Q

Thank you. I appreciate the color. Thanks.

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

A

Thank you, Robert. Stay safe.

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

A

You too.

Operator: And I'm not showing any further questions at this time. I would now like to turn the conference call back over to Mr. 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.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may all disconnect.