

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Compass Diversified Holdings  
Form 10-Q  
October 31, 2018

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

Form 10-Q

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

For the quarterly period ended September 30, 2018

Or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

COMPASS DIVERSIFIED HOLDINGS

(Exact name of registrant as specified in its charter)

Delaware 001-34927 57-6218917  
(State or other jurisdiction of (Commission (I.R.S. employer  
incorporation or organization) file number) identification number)

COMPASS GROUP DIVERSIFIED HOLDINGS LLC

(Exact name of registrant as specified in its charter)

Delaware 001-34926 20-3812051  
(State or other jurisdiction of (Commission (I.R.S. employer  
incorporation or organization) file number) identification number)

301 Riverside Avenue

Second Floor

Westport, CT 06880

(203) 221-1703

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Exchange Act. "

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes " No ý

As of October 31, 2018, there were 59,900,000 Trust common shares of Compass Diversified Holdings outstanding.

---

COMPASS DIVERSIFIED HOLDINGS  
QUARTERLY REPORT ON FORM 10-Q  
For the period ended September 30, 2018  
TABLE OF CONTENTS

	Page Number
<u>FORWARD-LOOKING STATEMENTS</u>	4
PART I. FINANCIAL INFORMATION	
ITEM 1. <u>FINANCIAL STATEMENTS (UNAUDITED)</u>	
<u>CONDENSED CONSOLIDATED BALANCE SHEETS</u>	5
<u>CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS</u>	6
<u>CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)</u>	7
<u>CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY</u>	8
<u>CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS</u>	9
<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	11
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	38
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	71
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	71
PART II. OTHER INFORMATION	
ITEM 1. <u>LEGAL PROCEEDINGS</u>	72
ITEM 1A. <u>RISK FACTORS</u>	72
ITEM 6. <u>EXHIBITS</u>	72
<u>SIGNATURES</u>	73

NOTE TO READER

In reading this Quarterly Report on Form 10-Q, references to:

the "Trust" and "Holdings" refer to Compass Diversified Holdings;

"businesses," "operating segments," "subsidiaries" and "reporting units" refer to, collectively, the businesses controlled by the Company;

the "Company" refer to Compass Group Diversified Holdings LLC;

the "Manager" refer to Compass Group Management LLC ("CGM");

the "Trust Agreement" refer to the Second Amended and Restated Trust Agreement of the Trust dated as of December 6, 2016;

the "2014 Credit Facility" refer to the credit agreement, as amended from time to time, entered into on June 6, 2014 with a group of lenders led by Bank of America N.A. as administrative agent, which provides for a Revolving Credit Facility and a Term Loan;

the "2014 Revolving Credit Facility" refer to the \$550 million Revolving Credit Facility provided by the 2014 Credit Facility that matures in June 2019;

the "2018 Credit Facility" refer to the amended and restated credit agreement entered into on April 18, 2018 among the Company, the Lenders from time to time party thereto (the "Lenders"), Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (the "agent") and other agents party thereto.

the "2018 Revolving Credit Facility" refers to the \$600 million in revolving loans, swing line loans and letters of credit provided by the 2018 Credit Facility that matures in 2023;

the "2018 Term Loan" refer to the \$500 million term loan provided by the 2018 Credit Facility that matures in June 2021;

the "LLC Agreement" refer to the fifth amended and restated operating agreement of the Company dated as of December 6, 2016; and

"we," "us" and "our" refer to the Trust, the Company and the businesses together.

#### FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, contains both historical and forward-looking statements. We may, in some cases, use words such as "project," "predict," "believe," "anticipate," "plan," "expect," "estimate," "intend," "should," "would," "could," "potentially," "may," or other words that convey uncertainty of future events or outcomes to identify these forward-looking statements. Forward-looking statements in this Quarterly Report on Form 10-Q are subject to a number of risks and uncertainties, some of which are beyond our control, including, among other things:

- our ability to successfully operate our businesses on a combined basis, and to effectively integrate and improve future acquisitions;
- our ability to remove CGM and CGM's right to resign;
- our organizational structure, which may limit our ability to meet our dividend and distribution policy;
- our ability to service and comply with the terms of our indebtedness;
- our cash flow available for distribution and reinvestment and our ability to make distributions in the future to our shareholders;
- our ability to pay the management fee and profit allocation if and when due;
- our ability to make and finance future acquisitions;
- our ability to implement our acquisition and management strategies;
- the regulatory environment in which our businesses operate;
- trends in the industries in which our businesses operate;
- changes in general economic or business conditions or economic or demographic trends in the United States and other countries in which we have a presence, including changes in interest rates and inflation;
- environmental risks affecting the business or operations of our businesses;
- our and CGM's ability to retain or replace qualified employees of our businesses and CGM;
- costs and effects of legal and administrative proceedings, settlements, investigations and claims; and
- extraordinary or force majeure events affecting the business or operations of our businesses.

Our actual results, performance, prospects or opportunities could differ materially from those expressed in or implied by the forward-looking statements. Additional risks of which we are not currently aware or which we currently deem immaterial could also cause our actual results to differ.

In light of these risks, uncertainties and assumptions, you should not place undue reliance on any forward-looking statements. The forward-looking events discussed in this Quarterly Report on Form 10-Q may not occur. These forward-looking statements are made as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly update or revise any forward-looking statements to reflect subsequent events or circumstances, whether as a result of new information, future events or otherwise, except as required by law.

PART I  
FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

COMPASS DIVERSIFIED HOLDINGS  
CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2018	December 31, 2017
(in thousands)		
Assets		
Current assets:		
Cash and cash equivalents	\$ 36,156	\$ 39,885
Accounts receivable, net	308,627	215,108
Inventories	328,548	246,928
Prepaid expenses and other current assets	38,479	24,897
Total current assets	711,810	526,818
Property, plant and equipment, net	226,270	173,081
Goodwill	736,947	531,689
Intangible assets, net	750,072	580,517
Other non-current assets	12,666	8,198
Total assets	\$ 2,437,765	\$ 1,820,303
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 105,865	\$ 84,538
Accrued expenses	145,034	106,873
Due to related party	10,891	7,796
Current portion, long-term debt	5,000	5,685
Other current liabilities	16,181	7,301
Total current liabilities	282,971	212,193
Deferred income taxes	78,207	81,049
Long-term debt	1,104,348	584,347
Other non-current liabilities	18,212	16,715
Total liabilities	1,483,738	894,304
Commitments and contingencies		
Stockholders' equity		
Trust preferred shares, 50,000 authorized; 8,000 shares issued and outstanding at September 30, 2018 and 4,000 shares issued and outstanding at December 31, 2017		
Series A preferred shares, no par value; 4,000 shares issued and outstanding at September 30, 2018 and December 31, 2017	96,417	96,417
Series B preferred shares, no par value; 4,000 shares issued and outstanding at September 30, 2018	96,504	—
Trust common shares, no par value, 500,000 authorized; 59,900 shares issued and outstanding at September 30, 2018 and December 31, 2017	924,680	924,680
Accumulated other comprehensive loss	(4,354	) (2,573
Accumulated deficit	(216,929	) (145,316
Total stockholders' equity attributable to Holdings	896,318	873,208
Noncontrolling interest	57,709	52,791
Total stockholders' equity	954,027	925,999
Total liabilities and stockholders' equity	\$ 2,437,765	\$ 1,820,303
See notes to condensed consolidated financial statements.		



COMPASS DIVERSIFIED HOLDINGS  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

(in thousands, except per share data)	Three months ended		Nine months ended	
	September 30, 2018	2017	September 30, 2018	2017
Net revenues	\$448,700	\$323,957	\$1,239,150	\$921,330
Cost of revenues	298,996	206,232	812,653	599,552
Gross profit	149,704	117,725	426,497	321,778
Operating expenses:				
Selling, general and administrative expense	96,906	80,804	295,178	239,102
Management fees	10,982	8,277	32,842	24,308
Amortization expense	17,562	14,167	49,280	39,256
Impairment expense	—	—	—	8,864
Operating income	24,254	14,477	49,197	10,248
Other income (expense):				
Interest expense, net	(15,699 )	(6,945 )	(35,465 )	(22,499 )
Amortization of debt issuance costs	(927 )	(1,004 )	(2,978 )	(2,940 )
Loss on investment in FOX	—	—	—	(5,620 )
Other income (expense), net	492	2,020	(3,094 )	2,950
Income (loss) from continuing operations before income taxes	8,120	8,548	7,660	(17,861 )
Provision (benefit) for income taxes	2,354	192	4,147	(2,002 )
Income (loss) from continuing operations	5,766	8,356	3,513	(15,859 )
Gain on sale of discontinued operations, net of income tax	—	—	1,165	340
Net income (loss)	5,766	8,356	4,678	(15,519 )
Less: Net income attributable to noncontrolling interest	1,040	650	3,201	2,492
Net income (loss) attributable to Holdings	\$4,726	\$7,706	\$1,477	\$(18,011 )
Amounts attributable to Holdings				
Income (loss) from continuing operations	\$4,726	\$7,706	\$312	\$(18,351 )
Gain on sale of discontinued operations, net of income tax	—	—	1,165	340
Net income (loss) attributable to Holdings	\$4,726	\$7,706	\$1,477	\$(18,011 )
Basic income (loss) per common share attributable to Holdings (refer to Note I)				
Continuing operations	\$(0.07 )	\$0.10	\$(0.22 )	\$(1.03 )
Discontinued operations	—	—	0.02	0.01
	\$(0.07 )	\$0.10	\$(0.20 )	\$(1.02 )
Basic weighted average number of shares of common shares outstanding	59,900	59,900	59,900	59,900
Cash distributions declared per Trust common share (refer to Note I)	\$0.36	\$0.36	\$1.08	\$1.08

See notes to condensed consolidated financial statements.



COMPASS DIVERSIFIED HOLDINGS  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (Unaudited)

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income (loss)	\$5,766	\$8,356	\$4,678	\$(15,519)
Other comprehensive income (loss)				
Foreign currency translation adjustments	1,603	3,370	(2,424)	6,955
Pension benefit liability, net	34	(4)	643	376
Other comprehensive income (loss)	1,637	3,366	(1,781)	7,331
Total comprehensive income (loss), net of tax	7,403	11,722	2,897	(8,188)
Less: Net income attributable to noncontrolling interests	1,040	650	3,201	2,492
Less: Other comprehensive income (loss) attributable to noncontrolling interests	266	675	(462)	1,336
Total comprehensive income (loss) attributable to Holdings, net of tax	\$6,097	\$10,397	\$158	\$(12,016)

See notes to condensed consolidated financial statements.

COMPASS DIVERSIFIED HOLDINGS  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(Unaudited)

(in thousands)	Trust Preferred Shares		Trust Common Shares	Accumulated Deficit	Accumulated Other Comprehensive Loss	Stockholders' Equity Attributable to Holdings	Non-Controlling Interest	Total Stockholders' Equity
	Series A	Series B						
Balance — January 1, 2017	\$7—	\$—	\$924,680	\$(58,760 )	\$ (9,515 )	\$ 856,405	\$ 38,139	\$ 894,544
Net income (loss)	—	—	—	(18,011 )	—	(18,011 )	2,492	(15,519 )
Total comprehensive loss, net	—	—	—	—	7,331	7,331	—	7,331
Issuance of Trust preferred shares, net of offering costs	96,417	—	—	—	—	96,417	—	96,417
Option activity attributable to noncontrolling shareholders	—	—	—	—	—	—	4,952	4,952
Effect of subsidiary stock option exercise	—	—	—	—	—	—	1,222	1,222
Issuance of subsidiary shares	—	—	—	—	—	—	40	40
Acquisition of Velocity Outdoor (formerly Crosman)	—	—	—	—	—	—	781	781
Distributions paid - Allocation Interests	—	—	—	(25,834 )	—	(25,834 )	—	(25,834 )
Distributions paid - Trust Common Shares	—	—	—	(64,692 )	—	(64,692 )	—	(64,692 )
Balance — September 30, 2017	\$96,417	—	\$924,680	\$(167,297 )	\$ (2,184 )	\$ 851,616	\$ 47,626	\$ 899,242
Balance — January 1, 2018	\$96,417	—	\$924,680	\$(145,316 )	\$ (2,573 )	\$ 873,208	\$ 52,791	\$ 925,999
Net income (loss)	—	—	—	1,477	—	1,477	3,201	4,678
Total comprehensive loss, net	—	—	—	—	(1,781 )	(1,781 )	—	(1,781 )
Issuance of Trust preferred shares, net of offering costs	—	96,504	—	—	—	96,504	—	96,504
Option activity attributable to noncontrolling shareholders	—	—	—	—	—	—	7,694	7,694
Effect of subsidiary stock option exercise	—	—	—	—	—	—	395	395
Purchase of noncontrolling interest	—	—	—	—	—	—	(6,372 )	(6,372 )
Distributions paid - Trust Common Shares	—	—	—	(64,692 )	—	(64,692 )	—	(64,692 )

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Distributions paid - Trust Preferred Shares	—	—	—	(8,398 )	—	(8,398 )	—	(8,398 )
Balance — September 30, 2018	\$96,417	\$96,504	\$924,680	\$(216,929 )	\$(4,354 )	\$896,318	\$57,709	\$954,027

See notes to condensed consolidated financial statements.

COMPASS DIVERSIFIED HOLDINGS  
 CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
 (Unaudited)

(in thousands)	Nine months ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	\$4,678	\$(15,519)
Gain on sale of discontinued operations, net	1,165	340
Net income (loss) from continuing operations	3,513	(15,859 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation expense	31,272	24,505
Amortization expense	56,606	64,154
Impairment expense	—	8,864
Amortization of debt issuance costs and original issue discount	3,403	3,721
Unrealized (gain) loss on interest rate swap	(4,649 )	1,178
Noncontrolling stockholder stock based compensation	7,694	4,952
Excess tax benefit from subsidiary stock options exercised	—	(417 )
Loss on investment in FOX	—	5,620
Provision for loss on receivables	459	4,310
Deferred taxes	(6,622 )	(17,937 )
Other	46	494
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(37,103)	(1,015 )
Inventories	(31,242)	(24,222 )
Other current and non-current assets	(9,434 )	(4,501 )
Accounts payable and accrued expenses	44,829	5,389
Cash provided by operating activities	58,772	59,236
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(551,873)	(164,742 )
Purchases of property and equipment	(41,158)	(30,955 )
Net proceeds from sale of equity investment	—	136,147
Payment of interest rate swap	(1,444 )	(3,050 )
Proceeds from sale of business	—	340
Other investing activities	(230 )	(696 )
Cash used in investing activities	(594,705)	(62,956 )

COMPASS DIVERSIFIED HOLDINGS  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	Nine months ended	
	September 30, 2018	2017
Cash flows from financing activities:		
Proceeds from the issuance of Trust preferred shares, net	96,504	96,417
Borrowings under credit facility	1,252,750	214,500
Repayments under credit facility	(1,125,473)	(197,664)
Issuance of Senior Notes	400,000	—
Distributions paid - common shares	(64,692 )	(64,692 )
Distributions paid - preferred shares	(8,398 )	—
Net proceeds provided by noncontrolling shareholders	395	821
Distributions paid to allocation interest holders (refer to Note I)	—	(39,188 )
Repurchase of subsidiary stock	(6,372 )	—
Excess tax benefit from subsidiary stock options exercised	—	417
Debt issuance costs	(14,887 )	(1,433 )
Other	1,461	(1,316 )
Net cash provided by financing activities	531,288	7,862
Foreign currency impact on cash	916	(2,427 )
Net decrease in cash and cash equivalents	(3,729 )	1,715
Cash and cash equivalents — beginning of period	39,885	39,772
Cash and cash equivalents — end of period	\$36,156	\$41,487

See notes to condensed consolidated financial statements.

COMPASS DIVERSIFIED HOLDINGS  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)  
September 30, 2018

Note A - Presentation and Principles of Consolidation

Compass Diversified Holdings, a Delaware statutory trust (the "Trust" or "Holdings") and Compass Group Diversified Holdings, LLC, a Delaware limited liability company (the "Company" or "CODI"), were formed to acquire and manage a group of small and middle-market businesses headquartered in North America. In accordance with the second amended and restated Trust Agreement, dated as of December 6, 2016 (as amended and restated, the "Trust Agreement"), the Trust is sole owner of 100% of the Trust Interests (as defined in the Company's fifth amended and restated operating agreement, dated as of December 6, 2016 (as amended and restated, the "LLC Agreement")) of the Company and, pursuant to the LLC Agreement, the Company has, outstanding, the identical number of Trust Interests as the number of outstanding shares of the Trust. The Company is the operating entity with a board of directors and other corporate governance responsibilities, similar to that of a Delaware corporation.

The Company is a controlling owner of ten businesses, or reportable operating segments, at September 30, 2018. The segments are as follows: 5.11 Acquisition Corp. ("5.11" or "5.11 Tactical"), Velocity Outdoor, Inc. (formerly Crosman Corp.) ("Velocity Outdoor" or "Velocity"), The Ergo Baby Carrier, Inc. ("Ergobaby"), Liberty Safe and Security Products, Inc. ("Liberty Safe" or "Liberty"), Fresh Hemp Foods Ltd. ("Manitoba Harvest"), Compass AC Holdings, Inc. ("ACI" or "Advanced Circuits"), AMT Acquisition Corporation ("Arnold"), Clean Earth Holdings, Inc. ("Clean Earth"), FFI Compass Inc. ("Foam Fabricators" or "Foam") and Sterno Products, LLC ("Sterno"). Refer to Note D - "Operating Segment Data" for further discussion of the operating segments. Compass Group Management LLC, a Delaware limited liability company ("CGM" or the "Manager"), manages the day to day operations of the Company and oversees the management and operations of our businesses pursuant to a management services agreement ("MSA").

Basis of Presentation

The condensed consolidated financial statements for the three and nine month periods ended September 30, 2018 and September 30, 2017, are unaudited, and in the opinion of management, contain all adjustments necessary for a fair presentation of the condensed consolidated financial statements. Such adjustments consist solely of normal recurring items. Interim results are not necessarily indicative of results for a full year or any subsequent interim period. The condensed consolidated financial statements and notes are prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP" or "GAAP") and presented as permitted by Form 10-Q and do not contain certain information included in the annual consolidated financial statements and accompanying notes of the Company. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Consolidation

The condensed consolidated financial statements include the accounts of Holdings and all majority owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

Discontinued Operations

On September 21, 2016, the Company sold its Tridien subsidiary based on an enterprise value of \$25 million. After the allocation of proceeds to non-controlling interest holders and the payment of transaction expenses, the Company received approximately \$22.7 million in net proceeds related to debt and equity interests in Tridien. The Company recognized a gain of \$1.7 million in September 2016 as a result of the sale of Tridien. Approximately \$1.6 million of the proceeds received by the Company from the sale of Tridien were reserved as support for the Company's indemnification obligations for future claims against Tridien that the Company may have been liable for under the terms of the Tridien sale agreement. In the second quarter of 2018, all indemnification claims had been settled, and the Company recognized an additional \$1.2 million in gain on the sale of Tridien.

Seasonality

Earnings of certain of the Company's operating segments are seasonal in nature. Earnings from Liberty are typically lowest in the second quarter due to lower demand for safes at the onset of summer. Velocity Outdoor typically has

higher sales in the third and fourth quarter each year, reflecting the hunting and holiday seasons. Earnings from Clean Earth are typically lower during the winter months due to the limits on outdoor construction and development activity

because of the colder weather in the Northeastern United States. Sterno typically has higher sales in the second and fourth quarter of each year, reflecting the outdoor summer and holiday seasons, respectively.

#### Recently Adopted Accounting Pronouncements

##### Revenue from Contracts with Customers

As of January 1, 2018, the Company adopted Revenue from Contracts with Customers (Topic 606) ("ASC 606"). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The underlying principle of the new standard is that a company will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects what it expects to receive in exchange for the goods or services. The standard also requires disclosure of the amount, timing and uncertainty of cash flows arising from contracts with customers. The Company adopted the standard using the modified retrospective method for all contracts not completed as of the date of adoption. The reported results for reporting periods after January 1, 2018 are presented under the new revenue recognition guidance while prior period amounts were prepared under the previous revenue guidance which is also referred to herein as the "previous guidance". The Company determined that the impact from the new standard is immaterial to our revenue recognition model since the vast majority of our recognition is based on point in time control. Accordingly, the Company has not made any adjustments to opening retained earnings. Refer to Note C - "Revenue" for additional information regarding the Company's adoption of ASC 606.

##### Improving the Presentation of Net Periodic Pension Costs

In March 2017, the Financial Accounting Standards Board ("FASB") issued new guidance that will require employers that sponsor defined benefit plans to present the service cost component of net periodic benefit cost in the same income statement line item as other employee compensation costs arising from services rendered during the period, and requires the other components of net periodic pension cost to be presented in the income statement separately from the service component cost and outside a subtotal of income from operations. The new guidance shall be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company's Arnold business segment has a defined benefit plan covering substantially all of Arnold's employees at its Switzerland location. The adoption of this guidance on January 1, 2018 did not have a material impact upon our financial condition or results of operations.

##### Changes to the Definition of a Business

In January 2017, the FASB issued new guidance that changes the definition of a business to assist entities in evaluating when a set of transferred assets and activities constitutes a business. The guidance requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. If so, the set of transferred asset and activities is not a business. The guidance also requires a business to include at least one substantive process and narrows the definition of outputs by more closely aligning it with how outputs are described in the new revenue recognition guidance. The new standard was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The adoption of this guidance did not have a material impact upon our financial condition or results of operations.

##### Classification of Certain Cash Receipts and Cash Payments

In August 2016, the FASB issued an accounting standard update which updates the guidance as to how certain cash receipts and cash payments should be presented and classified within the statement of cash flows. The amended guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted, including adoption in an interim period. The adoption of this guidance on January 1, 2018 did not have a material impact on our consolidated financial statements.

#### Recently Issued Accounting Pronouncements

##### Leases

In February 2016, the FASB issued an accounting standard update related to the accounting for leases (Leases "Topic 842") which will require an entity to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. The standard update offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative



information about leasing arrangements to enable a user of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, the new standard is effective for annual reporting

periods beginning after December 15, 2018, including interim periods within that reporting period. Accordingly, this standard is effective for the Company on January 1, 2019. In July 2018, the FASB issued two updates to Topic 842 to clarify how to apply certain aspects of the new lease standard, and to give entities another option for transition and to provide lessors with a practical expedient to reduce the cost and complexity of implementing the new standard. The transition option allows entities to not apply the new lease standard in the comparative periods presented in the financial statements in the year of adoption. The Company is currently evaluating the effects of adoption of this new standard on the Company's consolidated financial statements as well as the expected transition method that will be used. This evaluation process includes reviewing all forms of leases, performing a completeness assessment over the lease population, analyzing the practical expedients available, implementing processes and information technology tools to assist in our ongoing lease data collection and analysis and updating our accounting policies and internal controls that will be impacted by Topic 842. Based on a preliminary assessment, the Company expects that most of its operating lease commitments will be subject to the new guidance and recognized as operating lease liabilities and right-of-use assets upon adoption, resulting in a significant increase in the assets and liabilities on the consolidated balance sheet. The Company is continuing its assessment, which may identify additional impacts this standard will have on its consolidated financial statements and related disclosures.

#### Note B — Acquisitions

##### Acquisition of Foam Fabricators

On February 15, 2018, pursuant to an agreement entered into on January 18, 2018, the Company, through a wholly owned subsidiary, FFI Compass, Inc. ("Buyer"), entered into a Stock Purchase Agreement (the "Purchase Agreement") with Warren F. Florkiewicz ("Seller") pursuant to which Buyer acquired all of the issued and outstanding capital stock of Foam Fabricators, Inc., a Delaware corporation ("Foam Fabricators"). Foam Fabricators is a leading designer and manufacturer of custom molded protective foam solutions and original equipment manufacturer ("OEM") components made from expanded polymers such as expanded polystyrene (EPS) and expanded polypropylene (EPP). Founded in 1957 and headquartered in Scottsdale, Arizona, it operates 13 molding and fabricating facilities across North America and provides products to a variety of end-markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building and other products.

The Company made loans to, and purchased a 100% controlling interest in Foam Fabricators. The final purchase price, after the working capital settlement and net of transaction costs, was approximately \$253.4 million. The Company funded the acquisition through a draw on the 2014 Revolving Credit Facility. The transaction was accounted for as a business combination. CGM acted as an advisor to the Company in the acquisition and will continue to provide integration services during the first year of the Company's ownership. CGM will receive integration service fees of \$2.25 million payable over a twelve month period as services are rendered.

The results of operations of Foam Fabricators have been included in the consolidated results of operations since the date of acquisition. Foam Fabricator's results of operations are reported as a separate operating segment. The table below provides the recording of assets acquired and liabilities assumed as of the acquisition date.

(in thousands)	Preliminary Measurement		Final
	Purchase Allocation	Period Adjustments	Purchase Allocation
	As of 2/15/18		As of 9/30/18
Assets:			
Cash	\$ 6,282	\$ —	\$ 6,282
Accounts receivable <sup>(1)</sup>	19,058	—	19,058
Inventory <sup>(2)</sup>	13,218	(6 )	13,212
Property, plant and equipment <sup>(3)</sup>	23,485	4,885	28,370
Intangible assets	121,392	(3,050 )	118,342
Goodwill	71,489	1,219	72,708
Other current and noncurrent assets	2,945	—	2,945
Total assets	257,869	3,048	260,917



## Liabilities:

Current liabilities	5,968	—	5,968
Other liabilities	115,033		115,033
Total liabilities	121,001	—	121,001

Net assets acquired	136,868	3,048	139,916
Intercompany loans to business	115,033	—	115,033
	\$251,901	\$3,048	\$254,949

## Acquisition Consideration

Purchase price	\$247,500	\$—	\$247,500
Cash acquired	3,646	2,433	3,188
Working capital adjustment	755	615	4,261
Total purchase consideration	\$251,901	\$3,048	\$254,949
Less: Transaction costs	1,552	—	1,552
Purchase price, net	\$250,349	\$3,048	\$253,397

(1) Includes \$19.4 million of gross contractual accounts receivable of which \$0.03 million is not expected to be collected. The fair value of accounts receivable approximated book value acquired.

(2) Includes \$0.7 million in inventory basis step-up, which was charged to cost of goods sold in the first quarter of 2018.

(3) Includes \$20.0 million of property, plant and equipment basis step-up.

The Company incurred \$1.6 million of transaction costs in conjunction with the Foam Fabricators acquisition, which was included in selling, general and administrative expense in the consolidated results of operations in the quarter ended March 31, 2018. The allocation of the purchase price presented above is based on management's estimate of the fair values using valuation techniques including income, cost and market approaches. In estimating the fair value of the acquired assets and assumed liabilities, the fair value estimates are based on, but not limited to, expected future revenue and cash flows, expected future growth rates and estimated discount rates. Current and noncurrent assets and current and other liabilities are valued at historical carrying values. Property, plant and equipment is valued through a purchase price appraisal and will be depreciated on a straight-line basis over the respective remaining useful lives of the assets. Goodwill is calculated as the excess of the consideration transferred over the fair value of the identifiable net assets acquired and represents the future economic benefits expected to arise from other intangible assets acquired that do not qualify for separate recognition, including assembled workforce and non-contractual relationships, as well as expected future synergies. The goodwill of \$72.7 million reflects the strategic fit of Foam Fabricators in the Company's niche industrial business. Foam Fabricators was an S corporation under Section 1362 of the Internal Revenue Code, and accordingly, taxable income of Foam Fabricators flowed through to its stockholder. The Company and the selling shareholder have agreed to make a joint Section 338(h)(10) election which will treat the acquisition as a deemed asset purchase for United States Federal income tax purposes and accordingly the goodwill is expected to be deductible for income tax purposes.

The intangible assets recorded related to the Foam Fabricators acquisition are as follows (in thousands):

Intangible assets	Amount	Estimated Useful Life
Tradename	\$4,215	10 years
Customer Relationships	114,127	15 years
	\$118,342	

The tradename was valued at \$4.2 million using a relief from royalty methodology, in which an asset is valuable to the extent that the ownership of the asset relieves the company from the obligation of paying royalties for the benefits generated by the asset. The customer relationships intangible asset was valued at \$114.1 million using an excess earnings methodology, in which an asset is valuable to the extent it enables its owners to earn a return in excess of the required returns on the other assets utilized in the business. The customer relationships intangible asset was derived using a risk adjusted discount rate.



### Acquisition of Rimports

On February 26, 2018, the Company's Sterno subsidiary acquired all of the issued and outstanding capital stock of Rimports, Inc., a Utah corporation ("Rimports"), pursuant to a Stock Purchase Agreement, dated January 23, 2018, by and among Sterno and Jeffery W. Palmer, individually and in his capacity as Seller Representative, the Jeffery Wayne Palmer Dynasty Trust dated December 26, 2011, the Angela Marie Palmer Irrevocable Trust dated December 26, 2011, the Angela Marie Palmer Charitable Lead Trust, the Fidelity Investments Charitable Gift Fund, the TAK Irrevocable Trust dated June 7, 2012, and the SAK Irrevocable Trust dated June 7, 2012. Headquartered in Provo, Utah, Rimports is a manufacturer and distributor of branded and private label scented wickless candle products used for home décor and fragrance. Rimports offers an extensive line of wax warmers, scented wax cubes, essential oils and diffusers, and other home fragrance systems, through the mass retailer channel.

Sterno purchased a 100% controlling interest in Rimports. The purchase price, after the working capital settlement and net of transaction costs, was approximately \$154.4 million, subject to any working capital adjustment. The purchase price of Rimports includes a potential earn-out of up to \$25 million contingent on the attainment of certain future performance criteria of Rimports for the twelve-month period from May 1, 2017 to April 30, 2018 and the fourteen month period from March 1, 2018 to April 30, 2019. The fair value of the contingent consideration was estimated at \$4.1 million. Sterno funded the acquisition through their intercompany credit facility with the Company. The transaction was accounted for as a business combination.

The results of operations of Rimports have been included in the consolidated results of operations since the date of acquisition. Rimport's results of operations are included in the Sterno operating segment. The table below provides the preliminary recording of assets acquired and liabilities assumed as of the acquisition date. The goodwill resulting from the purchase price allocation is expected to be deductible for income tax purposes since Rimports was previously an S-Corporation for Federal income tax purposes and the Company and the selling shareholders have agreed to make a joint Section 338(h)(10) election which will treat the acquisition as a deemed asset purchase for United States Federal income tax purposes.

(in thousands)	Preliminary Measurement		Preliminary
	Purchase Allocation	Period Adjustments	Purchase Allocation
	As of 2/26/18		As of 9/30/18
<b>Assets:</b>			
Cash	\$ 10,025	\$ —	\$ 10,025
Accounts receivable <sup>(1)</sup>	21,431	—	21,431
Inventory	29,691	4,711	34,402
Property, plant and equipment	1,493	1,886	3,379
Intangible assets	—	86,890	86,890
Goodwill	121,364	(109,746 )	11,618
Other current and noncurrent assets	446	—	446
Total assets	184,450	(16,259 )	168,191
<b>Liabilities</b>			
Current liabilities	9,034	—	9,034
Other liabilities <sup>(2)</sup>	25,000	(20,900 )	4,100
Total liabilities	34,034	(20,900 )	13,134
Net assets acquired	\$ 150,416	\$ 4,641	\$ 155,057

## Acquisition Consideration

Purchase price	\$ 145,000	\$—	\$ 145,000
Cash acquired	9,500	525	10,025
Working capital adjustment	(4,084 )	4,116	32
Total purchase consideration	150,416	4,641	155,057
Less: Transaction costs	632	—	632
Purchase price, net	\$ 149,784	\$ 4,641	\$ 154,425

(1) Includes \$23.8 million of gross contractual accounts receivable of which \$2.4 million is not expected to be collected. The fair value of accounts receivable approximated book value acquired.

(2) The purchase price of Rimports includes a potential earn-out of up to \$25 million contingent on the attainment of certain future performance criteria of Rimports for the twelve-month period from May 1, 2017 to April 30, 2018 and the fourteen month period from March 1, 2018 to April 30, 2019. The earn-out was valued at \$4.1 million using a probability weighted model.

The intangible assets recorded on a preliminary basis related to the Rimports acquisition are as follows (in thousands):

Intangible assets	Amount	Estimated Useful Life
Tradename	\$6,600	8 years
Customer Relationships	80,300	9 years
	\$86,900	

Sterno incurred \$0.6 million of transaction costs in conjunction with the acquisition of Rimports, which was included in selling, general and administrative expense in the consolidated results of operations in the quarter ended March 31, 2018. The allocation of the purchase price presented above is based on management's estimate of the fair values using valuation techniques including income, cost and market approaches. In estimating the fair value of the acquired assets and assumed liabilities, the fair value estimates are based on, but not limited to, expected future revenue and cash flows, expected future growth rates and estimated discount rates. Current and noncurrent assets and current liabilities are valued at historical carrying values. Property, plant and equipment was valued through a purchase price appraisal and will be depreciated on a straight-line basis over the respective remaining useful lives of the assets. Goodwill is calculated as the excess of the consideration transferred over the fair value of the identifiable net assets acquired and represents the future economic benefits expected to arise from other intangible assets acquired that do not qualify for separate recognition, including assembled workforce and non-contractual relationships, as well as expected future synergies.

## Acquisition of Velocity Outdoor (formerly Crosman Corp.)

On June 2, 2017, CBCP Acquisition Corp. (the "Buyer"), a wholly owned subsidiary of the Company, entered into an equity purchase agreement pursuant to which it acquired all of the outstanding equity interests of Bullseye Acquisition Corporation, the indirect owner of the equity interests of Crosman Corp. which is now known as Velocity Outdoor. Velocity Outdoor is a designer, manufacturer and marketer of airguns, archery products, laser aiming devices and related accessories. Headquartered in Bloomfield, New York, Velocity Outdoor serves over 425 customers worldwide, including mass merchants, sporting goods retailers, online channels and distributors serving smaller specialty stores and international markets.

The Company made loans to, and purchased an initial 98.9% controlling interest in Velocity. The purchase price, including proceeds from noncontrolling interests and net of transaction costs, was approximately \$150.4 million. Velocity's management invested in the transaction along with the Company, representing approximately 1.1% of the initial noncontrolling interest on a primary and fully diluted basis. The fair value of the noncontrolling interest was determined based on the enterprise value of the acquired entity multiplied by the ratio of the number of shares acquired by the minority holders to total shares. The transaction was accounted for as a business combination. CGM acted as an advisor to the Company in the acquisition and provided integration services during the first year of the Company's ownership of Velocity Outdoor. CGM received integration service fees of \$1.5 million payable quarterly over a twelve month period as services were rendered beginning in the quarter ended September 30, 2017. The

Company incurred \$1.5 million of transaction costs in conjunction with the Velocity acquisition, which was included in selling, general and administrative expense in the consolidated results of operations in the second quarter of 2017. The results of operations



of Velocity Outdoor have been included in the consolidated results of operations since the date of acquisition. Velocity's results of operations are reported as a separate operating segment as a branded consumer business.

The tradename was valued at \$53.5 million using a multi-period excess earnings methodology. The customer relationships intangible asset was valued at \$28.7 million using the distributor method, a variation of the multi-period excess earnings methodology, in which an asset is valuable to the extent it enables its owners to earn a return in excess of the required returns on the other assets utilized in the business. The technology was valued at \$2.4 million using a relief from royalty method.

#### Unaudited pro forma information

The following unaudited pro forma data for the nine months ended September 30, 2018 and the three and nine months ended September 30, 2017 gives effect to the acquisition of Velocity, Foam Fabricators and Sterno's acquisition of Rimports, as described above, as if the acquisitions had been completed as of January 1, 2017. The pro forma data gives effect to historical operating results with adjustments to interest expense, amortization and depreciation expense, management fees and related tax effects. The information is provided for illustrative purposes only and is not necessarily indicative of the operating results that would have occurred if the transaction had been consummated on the date indicated, nor is it necessarily indicative of future operating results of the consolidated companies and should not be construed as representing results for any future period.

(in thousands)	Three months	Nine months ended	
	ended September 30, 2017	September 30, 2018	September 30, 2017
Net sales	\$ 400,014	\$ 1,278,978	\$ 1,159,717
Gross profit	139,596	436,915	390,620
Operating income	24,239	52,305	33,797
Net loss	12,141	1,876	(8,448 )
Net loss attributable to Holdings	11,491	(1,325 )	(10,940 )
Basic and fully diluted net loss per share attributable to Holdings	\$ 0.16	\$(0.25 )	\$(0.90 )

#### Other acquisitions

##### Clean Earth

On May 23, 2018, Clean Earth acquired all of the outstanding capital stock of Environmental Soil Management, Inc. ("ESMI"), located in Fort Edward, New York and Loudon, New Hampshire. The acquisition provided Clean Earth the opportunity to geographically expand their soil and hazardous waste solutions in the New York and New England market. The purchase price was approximately \$30.7 million. In connection with the acquisition, Clean Earth recorded a preliminary purchase price allocation of approximately \$8.4 million in goodwill, and \$10.4 million in intangible assets.

On September 5, 2018, Clean Earth acquired the assets of Disposal and Recycling Technologies, Inc. ("DART"), for a purchase price of approximately \$17.6 million. DART has a RCRA Part B hazardous waste site in Charlotte, North Carolina and a water waste treatment facility in Detroit, Michigan. The acquisition of DART expands Clean Earth's geographical reach in the Midwest and Mid-Atlantic hazardous and non-hazardous waste markets and represents Clean Earth's first water waste treatment facility. Clean Earth has not completed the preliminary purchase price for DART and therefore has recorded the excess amount of the purchase price over net assets acquired as goodwill at September 30, 2018.

##### Velocity Outdoor

On September 4, 2018, Velocity Outdoor (formerly "Crosman Corp.") acquired all of the outstanding membership interests in Ravin Crossbows, LLC ("Ravin") for a purchase price of approximately \$98.0 million, net of transaction costs, plus a potential earn-out of up to \$25.0 million based on gross profit levels for the trailing twelve month period ending December 31, 2018. Velocity funded the acquisition and payment of related transaction costs through the issuance of an additional \$38.9 million in intercompany loans and the issuance of additional equity to the Company of \$60.6 million. Velocity has not completed the preliminary purchase price allocation for Ravin and has therefore recorded the excess amount of the purchase price over assets acquired less liabilities assumed of \$86.9 million as

goodwill at September 30, 2018. The potential earn-out has been valued at \$8.1 million based on actual results to date and a forecast for the fourth quarter of 2018.

Velocity incurred \$1.3 million in acquisition related costs in connection with the Ravin acquisition which were included in selling, general and administrative expense in the third quarter of 2018.

#### Note C — Revenue

Effective January 1, 2018, the Company adopted the provisions of Revenue from Contracts with Customers, or ASC 606. The adoption of the new revenue guidance represents a change in accounting principle that will more closely align revenue recognition with the transfer of control of the Company's goods and services and will provide financial statement readers with enhanced disclosures. In accordance with the new revenue guidance, revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these goods or services, and excludes any sales incentives or taxes collected from customers which are subsequently remitted to government authorities. The impacts from the adoption of the new revenue guidance primarily relates to the timing of revenue recognition for variable consideration received, consideration payable to a customer and recording right of return assets. Although these differences have been identified, the total impact to each reportable segment was not material to the consolidated financial statements. In addition, the accounting for the estimate of variable consideration in our contracts is not materially different compared to our current practice. The Company has established monitoring controls to identify new sales arrangements and changes in our business environment that could impact our current accounting assessment.

Performance Obligations - For 5.11, Velocity Outdoor, Ergobaby, Liberty Safe, Manitoba Harvest, Sterno, Arnold and Foam Fabricators, revenues are recognized when control of the promised goods or service is transferred to the customer, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods and services. Each product or service represents a separate performance obligation. For contracts that contain multiple products, the Company will evaluate those products to determine if they represent performance obligations based on whether those goods or services are distinct (by themselves or as part of a bundle of products). Further, the Company evaluated if the products were separately identifiable from other products in the contract. The Company concluded that the products are distinct and separately identifiable from other products in the contracts. The Company determines standalone selling prices based on the price at which the performance obligation is sold separately. The standalone selling price is directly observable as it is the price at which the Company sells its products separately to the customer. As the Company does not meet any of the requirements for over time recognition for any of its products at these operating segments, it will recognize revenue based on the point in time criteria based on the definition of control, which is generally upon shipment terms for products and when the service is performed for services. Transfer of control for Advanced Circuit's products qualify for over time revenue recognition because the products represent assets with no alternative use and the contracts include an enforceable right to payment for work completed to date. Advanced Circuits has selected the cost to cost input method of measuring progress to recognize revenue over time, based on the status of the work performed. The cost to cost method is representative of the value provided to the customer as it represents the Company's performance completed to date. However, due to the short-term nature of Advanced Circuit's production cycle, there is an immaterial difference between revenue recognition under the previous guidance and the new revenue recognition guidance. Clean Earth's arrangements qualify for over time revenue recognition as the customer simultaneously receives and consumes the benefits provided by the Company's performance. As the Company performs the service, another party would not need to re-perform any of the work completed by the Company to date. Clean Earth has elected to apply the as-invoiced practical expedient to record revenue as the services are provided, given the nature of the services provided and the frequency of billing under the customer contracts.

Shipping and handling costs - Costs associated with shipment of products to a customer are accounted for as a fulfillment cost and are included in cost of revenues. The Company has elected to apply the practical expedient for shipping costs under the new revenue guidance and will account for shipping and handling activities performed after control of a good has been transferred to the customer as a fulfillment cost and not a performance obligation. Therefore, both revenue and costs of shipping and handling will be recorded at the same time. As a result, any consideration (including freight and landing costs) related to these activities will be included as a component of the overall transaction consideration and allocated to the performance obligations of the contract.

Warranty - For product sales, the Company provides standard assurance-type warranties as the Company only warrants its products against defects in materials and workmanship (i.e., manufacturing flaws). Although the warranties are not required by law, the tasks performed over the warranty period are only to remediate instances when products do not meet the promised specifications. Customers do not have the option to purchase warranties separately. The Company's warranty periods generally range from 90 days to three years depending on the nature of the product and

18

---

are consistent with industry standards. The periods are reasonable to assure that products conform to specifications. The Company does not have a history of performing activities outside the scope of the standard warranty.

**Significant Judgments** - The Company's contracts with customers often include promises to transfer multiple products to a customer. Determining whether the promises are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Once the performance obligations are identified, the Company determines the transaction price, which includes estimating the amount of variable consideration to be included in the transaction price, if any. The Company then allocates the transaction price to each performance obligation in the contract based on a relative stand-alone selling price method. The corresponding revenues are recognized as the related performance obligations are satisfied as discussed above. Judgment is required to determine the standalone selling price for each distinct performance obligation. The Company determines standalone selling prices based on the price at which the performance obligation is sold separately and therefore observable.

**Variable Consideration** - Upon adoption of the new revenue guidance, the Company's policy around estimating variable consideration related to sales incentives (early pay discounts, rights of return, rebates, chargebacks, and other discounts) included in certain customer contracts remained consistent with previous guidance. These incentives are recorded as a reduction in the transaction price. Under the new guidance, variable consideration is estimated and included in total consideration at contract inception based on either the expected value method or the most likely outcome method. The method was applied consistently among each type of variable consideration and the Company applies the expected value method to estimate variable consideration. These estimates are based on historical experience, anticipated performance and the Company's best judgment at the time and as a result, reflect applicable constraints. The Company includes in the transaction price an amount of variable consideration estimated in accordance with the new guidance only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

In certain of the Company's arrangements related to product sales, a right of return exists, which is included in the transaction price. For these right of return arrangements, an asset (and corresponding adjustment to cost of sale) for its right to recover the products from the customers is recorded. The asset recognized will be the carrying amount of the product (for example, inventory) less any expected costs to recover the products (including potential decreases in the value to the Company of the returned product). Additionally, the Company records a refund liability for the amount of consideration that it does not expect to be entitled. The amounts associated with right of return arrangements are not material to the Company's statement of position or operating results.

**Sales and Other Similar Taxes** - The Company notes that under its contracts with customers, the customer is responsible for all sales and other similar taxes, which the Company will invoice the customer for if they are applicable. The new revenue guidance allows entities to make an accounting policy election to exclude sales taxes and other similar taxes from the measurement of the transaction price. The scope of this accounting policy election is the same as the scope of the policy election in the previous guidance. As the Company presents taxes on a net basis under the previous guidance there will be no change to the current presentation (net) as a result.

**Practical Expedients** - The Company has elected to make the following accounting policy elections through the adoption of the following practical expedients:

**Right to Invoice (Clean Earth)** - The Company will record the consideration from a customer in an amount that corresponds directly with the value to the customer of the Company's performance completed to date (for example, in a service contract where 25% of the service has been performed, the Company would recognize 25% of the revenue), the entity may recognize revenue in the amount to which the entity has a right to invoice.

**Sales and Other Similar Taxes** - The Company will exclude sales taxes and similar taxes from the measurement of transaction price and will ensure that it complies with the disclosure requirements of applicable accounting guidance.

**Cost to Obtain a Contract** - The Company will recognize the incremental costs of obtaining a contract as an expense when incurred as the amortization period of the asset that the Company otherwise would have recognized is one year or less.

**Promised Goods or Services that are Immaterial in the Context of a Contract** - The Company has elected to assess promised goods or services as performance obligations that are deemed to be immaterial in the context of a contract.

As such, the Company will not aggregate and assess immaterial items at the entity level. That is, when determining whether a good or service is immaterial in the context of a contract, the assessment will be made based on the application of the new revenue guidance at the contract level.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Disaggregated Revenue - Revenue Streams & Timing of Revenue Recognition - The Company disaggregates revenue by strategic business unit and by geography for each strategic business unit which are categories that depict how the nature, amount and uncertainty of revenue and cash flows are affected by economic factors. This disaggregation also represents how the Company evaluates its financial performance, as well as how the Company communicates its financial performance to the investors and other users of its financial statements. Each strategic business unit represents the Company's reportable segments and offers different products and services.

The following tables provide disaggregation of revenue by reportable segment geography for the three and nine months ended September 30, 2018 and 2017 (in thousands):

Three months ended September 30, 2018

	5.11	Ergo	Liberty	Manitoba Harvest	Velocity	ACI	Arnold	Clean Earth	Foam	Sterno	Total
United States	\$62,085	\$8,190	\$17,263	\$11,970	\$29,862	\$23,424	\$18,202	\$71,117	\$28,378	\$110,274	\$380,765
Canada	1,465	697	609	4,859	2,062	—	264	—	—	2,934	12,890
Europe	6,871	7,962	—	334	1,231	—	9,390	—	—	248	26,036
Asia Pacific	3,919	7,176	—	100	375	—	1,311	—	—	110	12,991
Other international	9,002	235	—	37	759	—	724	—	4,959	302	16,018
	\$83,342	\$24,260	\$17,872	\$17,300	\$34,289	\$23,424	\$29,891	\$71,117	\$33,337	\$113,868	\$448,700

Three months ended September 30, 2017

	5.11	Ergo	Liberty	Manitoba Harvest	Velocity	ACI	Arnold	Clean Earth	Sterno	Total
United States	\$52,767	\$10,787	\$18,423	\$3,228	\$29,907	\$22,436	\$15,933	\$55,676	\$47,036	\$256,193
Canada	1,749	916	—	10,123	1,842	—	366	—	4,344	19,340
Europe	6,082	7,901	—	387	1,372	—	8,771	—	814	25,327
Asia Pacific	2,001	7,991	—	341	318	—	1,013	—	285	11,949
Other international	9,406	240	—	(131)	1,010	—	406	—	217	11,148
	\$72,005	\$27,835	\$18,423	\$13,948	\$34,449	\$22,436	\$26,489	\$55,676	\$52,696	\$323,957

Nine months ended September 30, 2018

	5.11	Ergo	Liberty	Manitoba Harvest	Velocity	ACI	Arnold	Clean Earth	Foam	Sterno	Total
United States	\$192,382	\$25,790	\$60,126	\$36,737	\$80,629	\$68,454	\$54,417	\$199,579	\$70,604	\$255,054	\$1,043,772
Canada	5,938	2,277	1,615	14,810	5,118	—	978	—	—	9,750	40,486
Europe	23,334	21,795	—	1,119	4,377	—	29,065	—	—	1,210	80,900
Asia Pacific	12,344	19,713	—	358	978	—	3,803	—	—	481	37,677
Other international	18,024	801	—	145	3,164	—	2,223	—	11,384	574	36,315
	\$252,022	\$70,376	\$61,741	\$53,169	\$94,266	\$68,454	\$90,486	\$199,579	\$81,988	\$267,069	\$1,239,150

Nine months ended September 30, 2017

	5.11	Ergo	Liberty	Manitoba Harvest	Velocity	ACI	Arnold	Clean Earth	Sterno	Total
United States	\$ 165,383	\$ 31,460	\$ 66,008	\$ 22,646	\$ 37,790	\$ 66,404	\$ 47,744	\$ 153,370	\$ 146,827	\$ 737,632
Canada	5,153	2,445	—	18,020	2,483	—	970	—	12,621	41,692
Europe	17,122	19,133	—	1,357	2,140	—	25,329	—	2,283	67,364
Asia Pacific	7,353	23,675	—	581	440	—	3,540	—	1,012	36,601
Other international	33,460	1,024	—	21	1,349	—	1,838	—	349	38,041
	\$ 228,471	\$ 77,737	\$ 66,008	\$ 42,625	\$ 44,202	\$ 66,404	\$ 79,421	\$ 153,370	\$ 163,092	\$ 921,330

Note D — Operating Segment Data

At September 30, 2018, the Company had ten reportable operating segments. Each operating segment represents a platform acquisition. The Company's operating segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. A description of each of the reportable segments and the types of products and services from which each segment derives its revenues is as follows:

5.11 Tactical is a leading provider of purpose-built tactical apparel and gear for law enforcement, firefighters, EMS, and military special operations as well as outdoor and adventure enthusiasts. 5.11 is a brand known for innovation and authenticity, and works directly with end users to create purpose-built apparel and gear designed to enhance the safety, accuracy, speed and performance of tactical professionals and enthusiasts worldwide. Headquartered in Irvine, California, 5.11 operates sales offices and distribution centers globally, and 5.11 products are widely distributed in uniform stores, military exchanges, outdoor retail stores, its own retail stores and on 511tactical.com.

Ergobaby is a designer, marketer and distributor of wearable baby carriers and accessories, blankets and swaddlers, nursing pillows, and related products. Ergobaby primarily sells its Ergobaby and Baby Tula branded products through brick-and-mortar retailers, national chain stores, online retailers, its own websites and distributors and derives more than 50% of its sales from outside of the United States. Ergobaby is headquartered in Los Angeles, California.

Liberty Safe is a designer, manufacturer and marketer of premium home, gun and office safes in North America. From its over 300,000 square foot manufacturing facility, Liberty produces a wide range of home and gun safe models in a broad assortment of sizes, features and styles. Liberty is headquartered in Payson, Utah.

Manitoba Harvest is a pioneer and leader in the manufacture and distribution of branded, hemp-based foods and hemp-based ingredients. Manitoba Harvest's products, which include Hemp Hearts™, Hemp Heart Bites™, and Hemp protein powders, are currently carried in over 13,000 retail stores across the United States and Canada. Manitoba Harvest is headquartered in Winnipeg, Manitoba.

Velocity Outdoor is a leading designer, manufacturer, and marketer of airguns, archery products, laser aiming devices and related accessories. Velocity Outdoor offers its products under the highly recognizable Crosman, Benjamin, Ravin, LaserMax and CenterPoint brands that are available through national retail chains, mass merchants, dealer and distributor networks. Velocity Outdoor is headquartered in Bloomfield, New York.

Advanced Circuits is an electronic components manufacturing company that provides small-run, quick-turn and volume production rigid printed circuit boards. ACI manufactures and delivers custom printed circuit boards to customers primarily in North America. ACI is headquartered in Aurora, Colorado.

Arnold is a global manufacturer of engineered magnetic solutions for a wide range of specialty applications and end-markets, including aerospace and defense, motorsport/automotive, oil and gas, medical, general industrial, electric utility, reprographics and advertising specialty markets. Arnold produces high performance permanent magnets (PMAG), precision foil products (Precision Thin Metals or "PTM"), and flexible magnets (Flexmag™) that are mission critical in motors, generators, sensors and other systems and components. Based on its long-term relationships, Arnold has built a diverse and blue-chip customer base totaling more than 2,000 clients worldwide. Arnold is headquartered in Rochester, New York.



Clean Earth provides environmental services for a variety of contaminated materials including soils, dredged material, hazardous waste and drill cuttings. Clean Earth analyzes, treats, documents and recycles waste streams generated in multiple end-markets such as power, construction, oil and gas, infrastructure, industrial and dredging. Clean Earth is headquartered in Hatboro, Pennsylvania and operates 28 facilities in the eastern United States.

Foam Fabricators is a designer and manufacturer of custom molded protective foam solutions and original equipment manufacturer components made from expanded polystyrene and expanded polypropylene. Foam Fabricators provides products to a variety of end markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building and other products. Foam Fabricators is headquartered in Scottsdale, Arizona and operates 13 molding and fabricating facilities across North America.

Sterno is a manufacturer and marketer of portable food warming fuel and creative table lighting solutions for the food service industry and flameless candles, outdoor lighting products, scented wax cubes and warmer products for consumers. Sterno's products include wick and gel chafing fuels, butane stoves and accessories, liquid and traditional wax candles, scented wax cubes and warmer products used for home decor and fragrance systems, catering equipment and outdoor lighting products. Sterno is headquartered in Corona, California.

The tabular information that follows shows data for each of the operating segments reconciled to amounts reflected in the consolidated financial statements. The results of operations of each of the operating segments are included in consolidated operating results as of their date of acquisition. There were no significant inter-segment transactions.

#### Summary of Operating Segments

Net Revenues (in thousands)	Three months ended		Nine months ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
5.11 Tactical	\$83,342	\$72,005	\$252,022	\$228,471
Ergobaby	24,260	27,835	70,376	77,737
Liberty	17,872	18,423	61,741	66,008
Manitoba Harvest	17,300	13,948	53,169	42,625
Velocity Outdoor	34,289	34,449	94,266	44,202
ACI	23,424	22,436	68,454	66,404
Arnold	29,891	26,489	90,486	79,421
Clean Earth	71,117	55,676	199,579	153,370
Foam Fabricators	33,337	—	81,988	—
Sterno	113,868	52,696	267,069	163,092
Total segment revenue	448,700	323,957	1,239,150	921,330
Corporate and other	—	—	—	—
Total consolidated revenues	\$448,700	\$323,957	\$1,239,150	\$921,330

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Segment profit (loss) <sup>(1)</sup> (in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
5.11 Tactical	\$1,740	\$(253)	\$3,143	\$(14,542)
Ergobaby	4,191	5,884	10,106	14,728
Liberty	467	2,050	4,894	6,900
Manitoba Harvest	(885)	(169)	(670)	75
Velocity Outdoor	1,833	(1,388)	5,125	(1,587)
ACI	6,902	6,191	19,202	18,106
Arnold	2,287	2,000	6,957	(4,551)
Clean Earth	4,278	5,592	12,495	7,597
Foam Fabricators	4,100	—	7,856	—
Sterno	11,634	4,411	19,113	13,383
Total	36,547	24,318	88,221	40,109
Reconciliation of segment profit (loss) to consolidated income (loss) before income taxes:				
Interest expense, net	(15,699)	(6,945)	(35,465)	(22,499)
Other income (expense), net	492	2,020	(3,094)	2,950
Loss on equity method investment	—	—	—	(5,620)
Corporate and other <sup>(2)</sup>	(13,220)	(10,845)	(42,002)	(32,801)
Total consolidated income (loss) before income taxes	\$8,120	\$8,548	\$7,660	\$(17,861)

<sup>(1)</sup> Segment profit (loss) represents operating income (loss).

<sup>(2)</sup> Primarily relates to management fees expensed and payable to CGM, and corporate overhead expenses.

Depreciation and Amortization Expense (in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
5.11 Tactical	\$5,323	\$4,338	\$15,882	\$34,882
Ergobaby	2,086	3,068	6,374	9,386
Liberty	414	358	1,130	1,295
Manitoba Harvest	1,599	1,891	4,800	4,922
Velocity Outdoor	2,077	5,593	6,081	5,842
ACI	786	817	2,384	2,517
Arnold	1,572	1,452	4,656	4,962
Clean Earth	6,349	5,687	17,392	16,140
Foam Fabricators	2,957	—	7,724	—
Sterno	7,584	2,873	21,455	8,713
Total	30,747	26,077	87,878	88,659
Reconciliation of segment to consolidated total:				
Amortization of debt issuance costs and original issue discount	1,079	1,261	3,403	3,721
Consolidated total	\$31,826	\$27,338	\$91,281	\$92,380

Edgar Filing: Compass Diversified Holdings - Form 10-Q

	Accounts Receivable		Identifiable Assets	
	September 30, 2018	December 31, 2017	September 30, 2018 <sup>(1)</sup>	December 31, 2017 <sup>(1)</sup>
(in thousands)				
5.11 Tactical	\$53,509	\$60,481	\$320,777	\$324,068
Ergobaby	12,612	12,869	102,251	105,672
Liberty	9,477	13,679	29,368	26,715
Manitoba Harvest	6,596	5,663	92,307	95,046
Velocity Outdoor	28,362	20,396	149,681	129,033
ACI	8,356	6,525	15,391	14,522
Arnold	20,506	14,804	64,843	66,979
Clean Earth	64,771	50,599	199,134	183,508
Foam Fabricators	25,012	—	159,748	—
Sterno	92,535	40,087	255,726	125,937
Allowance for doubtful accounts	(13,109 )	(9,995 )	—	—
Total	308,627	215,108	1,389,226	1,071,480
Reconciliation of segment to consolidated total:				
Corporate and other identifiable assets	—	—	2,965	2,026
Total	\$308,627	\$215,108	\$1,392,191	\$1,073,506

(1) Does not include accounts receivable balances per schedule above or goodwill balances - refer to Note F - "Goodwill and Other Intangible Assets".

Note E — Property, Plant and Equipment and Inventory

Property, plant and equipment

Property, plant and equipment is comprised of the following at September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018	December 31, 2017
Machinery and equipment	\$215,575	\$178,187
Furniture, fixtures and other	45,283	28,824
Leasehold improvements	43,098	20,630
Buildings and land	47,740	40,015
Construction in process	17,373	18,153
	369,069	285,809
Less: accumulated depreciation	(142,799 )	(112,728 )
Total	\$226,270	\$173,081

Depreciation expense was \$11.1 million and \$31.3 million for the three and nine months ended September 30, 2018, and \$8.7 million and \$24.5 million for the three and nine months ended September 30, 2017, respectively.

## Inventory

Inventory is comprised of the following at September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	\$67,795	\$36,124
Work-in-process	17,275	13,921
Finished goods	261,558	205,512
Less: obsolescence reserve	(18,080 )	(8,629 )
Total	\$328,548	\$246,928

## Note F — Goodwill and Other Intangible Assets

As a result of acquisitions of various businesses, the Company has significant intangible assets on its balance sheet that include goodwill and indefinite-lived intangibles. The Company's goodwill and indefinite-lived intangibles are tested and reviewed for impairment annually as of March 31st or more frequently if facts and circumstances warrant by comparing the fair value of each reporting unit to its carrying value. Each of the Company's businesses represent a reporting unit. The Arnold business previously comprised three reporting units when it was acquired in March 2012, but as a result of changes implemented by Arnold management during 2016 and 2017, the Company reassessed the reporting units at Arnold as of the annual impairment testing date in 2018. After evaluating changes in the operation of the reporting units that led to increased integration and altered how the financial results of the Arnold operating segment were assessed by Arnold management, the Company determined that the previously identified reporting units no longer operate in the same manner as they did when the Company acquired Arnold. As a result, the separate Arnold reporting units were determined to only comprise one reporting unit at the Arnold operating segment level as of March 31, 2018. As part of the exercise of combining the separate Arnold reporting units into one reporting unit, the Company performed "before" and "after" goodwill impairment testing, whereby we performed the annual impairment testing for each of the existing reporting units of Arnold and then subsequent to the completion of the annual impairment testing of the separate reporting units, we performed a quantitative impairment test of the Arnold operating segment, which will represent the reporting unit for future impairment tests.

## Goodwill

## 2018 Annual Impairment Testing

The Company uses a qualitative approach to test goodwill for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform quantitative goodwill impairment testing. For the reporting units that were tested qualitatively for the 2018 annual impairment testing, the results of the qualitative analysis indicated that the fair value exceeded their carrying value. At March 31, 2018, we determined that the Flexmag reporting unit of Arnold required additional quantitative testing because we could not conclude that the fair value of the reporting unit exceeded its carrying value based on qualitative factors alone. For the quantitative impairment test of Flexmag, we estimated the fair value of the reporting unit using an income approach, whereby we estimate the fair value of the reporting unit based on the present value of future cash flows. Cash flow projections are based on management's estimate of revenue growth rates and operating margins and take into consideration industry and market conditions as well as company and reporting unit specific economic conditions. The discount rate used is based on the weighted average cost of capital adjusted for the relevant risk associated with the business and the uncertainty associated with the reporting unit's ability to execute on the projected cash flows. The discount rate used in the income approach for Flexmag was 12.4%.

For the reporting unit change at Arnold, a quantitative impairment test was performed of the Arnold business at March 31, 2018 using an income approach. The discount rate used in the income approach was 12.6%. The results of the impairment testing indicated that the fair value of the Arnold reporting unit exceeded the carrying value.

## 2017 Interim Impairment Testing

## Manitoba Harvest

The Company performed quantitative testing during the 2017 annual impairment testing for Manitoba Harvest, the results of which indicated that the fair value of Manitoba Harvest exceeded the carrying value. As a result of operating results that were below forecast amounts, as well as a failure of the financial covenants associated with the intercompany

25

---

credit facility, we determined that a triggering event had occurred at Manitoba Harvest in the fourth quarter of 2017. We performed impairment testing of the goodwill and indefinite lived tradename at December 31, 2017. For the quantitative impairment test at Manitoba Harvest, we utilized an income approach. The weighted average cost of capital used in the income approach at Manitoba Harvest was 11.7%. Results of the quantitative testing of Manitoba Harvest indicated that the carrying value of Manitoba Harvest exceeded its fair value by \$6.3 million, and the Company recorded \$6.2 million (after the effect of foreign currency translation) as impairment expense at December 31, 2017. For the indefinite lived trade name, quantitative testing of the Manitoba Harvest tradename indicated that the carrying value exceeded its fair value by \$2.3 million, and the Company recorded \$2.3 million (after the effect of foreign currency translation) of impairment expense at December 31, 2017. The Company finalized the Manitoba Harvest impairment testing during the first quarter of 2018 with no changes to the impairment expense recorded as of December 31, 2017.

A summary of the net carrying value of goodwill at September 30, 2018 and December 31, 2017, is as follows (in thousands):

	Nine months ended September 30, 2018	Year ended December 31, 2017
Goodwill - gross carrying amount	\$ 768,100	\$ 562,842
Accumulated impairment losses	(31,153 )	(31,153 )
Goodwill - net carrying amount	\$ 736,947	\$ 531,689

The following is a reconciliation of the change in the carrying value of goodwill for the nine months ended September 30, 2018 by operating segment (in thousands):

	Balance at January 1, 2018	Acquisitions (1)	Goodwill Impairment	Foreign currency translation	Other	Balance at September 30, 2018
5.11	\$ 92,966	\$ —	\$ —	—\$ —	\$ —	\$ 92,966
Ergobaby	61,031	—	—	—	—	61,031
Liberty	32,828	—	—	—	—	32,828
Manitoba Harvest	41,024	—	—	(1,130 )	—	39,894
Velocity Outdoor	49,352	86,890	—	—	70	136,312
ACI	58,019	—	—	—	—	58,019
Arnold (2)	26,903	—	—	—	—	26,903
Clean Earth	119,099	35,102	—	—	—	154,201
Foam Fabricators	—	72,708	—	—	—	72,708
Sterno	41,818	11,618	—	—	—	53,436
Corporate (3)	8,649	—	—	—	—	8,649
Total	\$ 531,689	\$ 206,318	\$ —	—\$ (1,130 )	\$ 70	\$ 736,947

Sterno's acquisition of Rimports and Clean Earth's acquisition of ESMI are based on a preliminary purchase price (1)allocations that are expected to be finalized during the fourth quarter of 2018. The preliminary purchase prices for Clean Earth's acquisition of ESMI and Velocity's acquisition of Ravin have not been completed and the goodwill reflected in the table represents the excess of the purchase price over the net assets acquired.

(2) Arnold had three reporting units which were combined into one reporting unit effective March 31, 2018.

(3) Represents goodwill resulting from purchase accounting adjustments not "pushed down" to the ACI segment. This amount is allocated back to the ACI segment for purposes of goodwill impairment testing.

Long lived assets

Annual indefinite lived impairment testing

The Company used a qualitative approach to test indefinite lived intangible assets for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of an indefinite lived intangible asset is impaired as a basis for determining whether it is necessary to perform quantitative impairment testing. The Company evaluated the qualitative factors of each reporting unit that maintains indefinite lived intangible assets in connection with the annual impairment testing for 2018 and 2017. Results of the qualitative analysis indicate that the

Edgar Filing: Compass Diversified Holdings - Form 10-Q

carrying value of the Company's indefinite lived intangible assets did not exceed their fair value. The Manitoba Harvest trade name was tested for impairment as part of the interim impairment testing for Manitoba Harvest at December 31, 2017 as noted above, resulting in impairment expense of \$2.3 million at December 31, 2017.

Other intangible assets are comprised of the following at September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$538,148	\$ (130,653 )	\$407,495	\$338,719	\$ (102,271 )	\$236,448
Technology and patents	50,714	(25,751 )	24,963	49,075	(22,492 )	26,583
Trade names, subject to amortization	194,814	(33,337 )	161,477	182,976	(22,518 )	160,458
Licensing and non-compete agreements	8,055	(6,836 )	1,219	7,965	(6,488 )	1,477
Permits and airspace	122,722	(38,713 )	84,009	115,230	(31,026 )	84,204
Distributor relations and other	726	(726 )	—	726	(646 )	80
Total	915,179	(236,016 )	679,163	694,691	(185,441 )	509,250
Trade names, not subject to amortization	70,909	—	70,909	71,267	—	71,267
Total intangibles, net	\$986,088	\$ (236,016 )	\$750,072	\$765,958	\$ (185,441 )	\$580,517

Amortization expense related to intangible assets was \$17.6 million and \$14.2 million for the three months ended September 30, 2018 and 2017, respectively, and \$49.3 million and \$39.3 million for the nine months ended September 30, 2018 and 2017, respectively. Estimated charges to amortization expense of intangible assets for the remainder of 2018 and the next four years, is as follows (in thousands):

	2018	2019	2020	2021	2022
	\$19,784	\$79,707	\$70,086	\$60,373	\$58,694

Note G — Warranties

The Company's Velocity Outdoor, Ergobaby and Liberty operating segments estimate their exposure to warranty claims based on both current and historical product sales data and warranty costs incurred. The Company assesses the adequacy of its recorded warranty liability quarterly and adjusts the amount as necessary. A reconciliation of the change in the carrying value of the Company's warranty liability for the nine months ended September 30, 2018 and the year ended December 31, 2017 is as follows (in thousands):

	Nine months ended September 30, 2018	Year ended December 31, 2017
Warranty liability:		
Beginning balance	\$ 2,197	\$ 1,258
Provision for warranties issued during the period	2,252	1,982
Fulfillment of warranty obligations	(2,417 )	(1,552 )
Other <sup>(1)</sup>	154	509
Ending balance	\$ 2,186	\$ 2,197

<sup>(1)</sup> Represents the warranty liability recorded in relation to acquisitions. Warranty liabilities of acquisitions are recorded at fair value as of the date of acquisition.

Note H — Debt

2018 Credit Facility

On April 18, 2018, the Company entered into an Amended and Restated Credit Agreement (the "2018 Credit Facility") to amend and restate the 2014 Credit Facility, originally dated as of June 6, 2014 (as previously amended) among the





Company, the lenders from time to time party thereto (the “Lenders”), and Bank of America, N.A., as Administrative Agent. The 2018 Credit Facility is secured by all of the assets of the Company, including all of its equity interests in, and loans to, its consolidated subsidiaries.

The 2018 Credit Facility provides for (i) revolving loans, swing line loans and letters of credit (the “2018 Revolving Credit Facility”) up to a maximum aggregate amount of \$600 million, and (ii) a \$500 million term loan (the “2018 Term Loan”). The 2018 Term Loan was issued at an original issuance discount of 99.75%. The 2018 Term Loan requires quarterly payments of \$1.25 million commencing June 30, 2018, with a final payment of all remaining principal and interest due on April 18, 2025, the maturity date of the 2018 Term Loan. All amounts outstanding under the 2018 Revolving Credit Facility will become due on April 18, 2023, which is the maturity date of loans advanced under the 2018 Revolving Credit Facility. The 2018 Credit Facility also permits the Company, prior to the applicable maturity date, to increase the 2018 Revolving Loan Commitment and/or obtain additional term loans in an aggregate amount of up to \$250 million (the “Incremental Loans”), subject to certain restrictions and conditions.

The Company may borrow, prepay and reborrow principal under the 2018 Revolving Credit Facility from time to time during its term. Advances under the 2018 Revolving Credit Facility can be either Eurodollar rate loans or base rate loans. Eurodollar rate revolving loans bear interest on the outstanding principal amount thereof for each interest period at a rate per annum based on the London Interbank Offered Rate (the “Eurodollar Rate”) for such interest period plus a margin ranging from 1.50% to 2.50%, based on the ratio of consolidated net indebtedness to adjusted consolidated earnings before interest expense, tax expense, and depreciation and amortization expenses for such period (the “Consolidated Total Leverage Ratio”). Base rate revolving loans bear interest on the outstanding principal amount thereof at a rate per annum equal to the highest of (i) Federal Funds rate plus 0.50%, (ii) the “prime rate”, and (iii) Eurodollar Rate plus 1.0% (the “Base Rate”), plus a margin ranging from 0.50% to 1.50%, based on the Company's Consolidated Total Leverage Ratio.

Under the 2018 Revolving Credit Facility, an aggregate amount of up to \$100 million in letters of credit may be issued, as well as swing line loans of up to \$25 million outstanding at one time. The issuance of such letters of credit and the making of any swing line loan would reduce the amount available under the 2018 Revolving Credit Facility.

**2014 Credit Facility**  
The 2014 Credit Facility, as amended, provided for (i) a revolving credit facility of \$550 million, (ii) a \$325 million term loan (the “2014 Term Loan”), and (iii) a \$250 million incremental term loan. The 2018 Credit Facility amended and restated the 2014 Credit Facility.

#### Senior Notes

On April 18, 2018, the Company consummated the issuance and sale of \$400 million aggregate principal amount of its 8.000% Senior Notes due 2026 (the “Notes” or “Senior Notes”) offered pursuant to a private offering to qualified institutional buyers in accordance with Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”), and to non-U.S. persons under Regulation S under the Securities Act. The Company used the net proceeds from the sale of the Notes to repay debt under its existing credit facilities in connection with a concurrent refinancing transaction described above. The Notes were issued pursuant to an indenture, dated as of April 18, 2018 (the “Indenture”), between the Company and U.S. Bank National Association, as trustee (the “Trustee”).

The Notes will bear interest at the rate of 8.000% per annum and will mature on May 1, 2026. Interest on the Notes is payable in cash on May 1st and November 1st of each year, beginning on November 1, 2018. The Notes are general senior unsecured obligations of the Company and are not guaranteed by the subsidiaries through which the Company currently conducts substantially all of its operations. The Notes rank equal in right of payment with all of the Company's existing and future senior unsecured indebtedness, and rank senior in right of payment to all of the Company's future subordinated indebtedness, if any. The Notes will be effectively subordinated to the Company's existing and future secured indebtedness, to the extent of the value of the assets securing such indebtedness, including the indebtedness under the Company's credit facilities described below.

The Indenture contains several restrictive covenants including, but not limited to, limitations on the following: (i) the incurrence of additional indebtedness, (ii) restricted payments, (iii) dividends and other payments affecting restricted subsidiaries, (iv) the issuance of preferred stock of restricted subsidiaries, (v) transactions with affiliates, (vi) asset sales and mergers and consolidations, (vii) future subsidiary guarantees and (viii) liens, subject in each case to certain exceptions.



The following table provides the Company's debt holdings at September 30, 2018 and December 31, 2017 (in thousands):

	September 30, 2018	December 31, 2017
Senior Notes	400,000	—
Revolving Credit Facility	\$233,000	\$42,000
Term Loan	497,500	559,973
Less: unamortized discounts and debt issuance costs	(21,152 )	(11,941 )
Total debt	\$1,109,348	\$590,032
Less: Current portion, term loan facilities	(5,000 )	(5,685 )
Long term debt	\$1,104,348	\$584,347

Net availability under the 2018 Revolving Credit Facility was approximately \$366.7 million at September 30, 2018. Letters of credit outstanding at September 30, 2018 totaled approximately \$0.3 million. At September 30, 2018, the Company was in compliance with all covenants as defined in the 2018 Credit Facility.

At September 30, 2018, the carrying value of the principal under the Company's outstanding Term Loan, including the current portion, was \$497.5 million, which approximates fair value because it has a variable interest rate that reflects market changes in interest rates and changes in the Company's net leverage ratio. The estimated fair value of the outstanding 2018 Term Loan is based on quoted market prices for similar debt issues and is, therefore, classified as Level 2 in the fair value hierarchy. The Company's Senior Notes consisted of the following carrying value and estimated fair value (in thousands):

	Maturity Date	Rate	Fair Value Hierarchy Level	September 30, 2018 Carrying Value	Fair Value
Senior Notes	May 1, 2026	8.000 %	2	400,000	416,000

#### Debt Issuance Costs

Deferred debt issuance costs represent the costs associated with the issuance of the Company's financing arrangements. The Company paid \$7.0 million in debt issuance costs related to the Senior Notes issuance, comprised of bank fees, rating agency fees and professional fees. The 2018 Credit Facility was categorized as a debt modification, and the Company incurred \$8.4 million of debt issuance costs, \$7.8 million of which were capitalized and will be amortized over the life of the related debt instrument, and \$0.6 million that were expensed as costs incurred. The Company recorded additional debt modification expense of \$0.6 million to write off previously capitalized debt issuance costs. Since the Company can borrow, repay and reborrow principal under the 2018 Revolving Credit Facility, the debt issuance costs associated with the 2014 and 2018 Revolving Credit Facility of \$5.6 million and \$2.8 million at September 30, 2018 and December 31, 2017, respectively, have been classified as other non-current assets in the accompanying consolidated balance sheet. The original issue discount and the debt issuance costs associated with the 2018 Term Loan and Senior Notes are classified as a reduction of long-term debt in the accompanying consolidated balance sheet.

#### Interest Rate Swap

In September 2014, the Company purchased an interest rate swap (the "Swap") with a notional amount of \$220 million. The Swap is effective April 1, 2016 through June 6, 2021, the original termination date of the 2014 Term Loan. The agreement requires the Company to pay interest on the notional amount at the rate of 2.97% in exchange for the three-month LIBOR rate. At September 30, 2018 and December 31, 2017, the Swap had a fair value loss of \$0.0 million and \$6.1 million, respectively, principally reflecting the present value of future payments and receipts under the agreement.

The following table reflects the classification of the Company's Swap on the consolidated balance sheets at September 30, 2018 and December 31, 2017 (in thousands):

	September 30, December	
	2018	31, 2017
Other non-current assets	\$ 539	\$—
Other current liabilities	(553 )	(2,468 )
Other noncurrent liabilities	—	(3,639 )
Total fair value	\$ (14 )	\$(6,107 )

#### Note I — Stockholders' Equity

##### Trust Common Shares

The Trust is authorized to issue 500,000,000 Trust shares and the Company is authorized to issue a corresponding number of LLC interests. The Company will at all times have the identical number of LLC interests outstanding as Trust shares. Each Trust share represents an undivided beneficial interest in the Trust, and each Trust share is entitled to one vote per share on any matter with respect to which members of the Company are entitled to vote.

##### Trust Preferred Shares

The Trust is authorized to issue up to 50,000,000 Trust preferred shares and the Company is authorized to issue a corresponding number of trust preferred interests.

##### Series B Preferred Shares

On March 13, 2018, the Trust issued 4,000,000 7.875% Series B Trust Preferred Shares (the "Series B Preferred Shares") with a liquidation preference of \$25.00 per share, for gross proceeds of \$100.0 million, or \$96.5 million net of underwriters' discount and issuance costs. Distributions on the Series B Preferred Shares will be payable quarterly in arrears, when and as declared by the Company's board of directors on January 30, April 30, July 30, and October 30 of each year, beginning on July 30, 2018, at a rate per annum of 7.875%. Distributions on the Series B Preferred Shares are cumulative. Unless full cumulative distributions on the Series B Preferred Shares have been or contemporaneously are declared and set apart for payment of the Series B Preferred Shares for all past distribution periods, no distribution may be declared or paid for payment on the Trust common shares. The Series B Preferred Shares are not convertible into Trust common shares and have no voting rights, except in limited circumstances as provided for in the share designation for the preferred shares. The Series B Preferred Shares may be redeemed at the Company's option, in whole or in part, at any time after April 30, 2028, at a price of \$25.00 per share, plus any accumulated and unpaid distributions (thereon whether authorized or declared) to, but excluding, the redemption date. Holders of Series B Preferred Shares will have no right to require the redemption of the Series B Preferred Shares and there is no maturity date.

If a certain tax redemption event occurs prior to April 30, 2028, the Series B Preferred Shares may be redeemed at the Company's option, in whole but not in part, upon at least 30 days' notice, within 60 days of the occurrence of such tax redemption event, at a price of \$25.25 per share, plus accumulated and unpaid distributions to, but excluding, the redemption date. If a certain fundamental change related to the Series B Preferred Shares or the Company occurs (whether before, on or after April 30, 2028), the Company will be required to repurchase the Series B Preferred Shares at a price of \$25.25 per share, plus accumulated and unpaid distributions to, but excluding, the date of purchase. If (i) a fundamental change occurs and (ii) the Company does not give notice prior to the 31st day following the fundamental change to repurchase all the outstanding Series B Preferred Shares, the distribution rate per annum on the Series B Preferred Shares will increase by 5.00%, beginning on the 31st day following such fundamental change. Notwithstanding any requirement that the Company repurchase all of the outstanding Series B Preferred Shares, the increase in the distribution rate is the sole remedy to holders in the event the Company fails to do so, and following any such increase, the Company will be under no obligation to repurchase any Series B Preferred Shares.

##### Series A Preferred Shares

On June 28, 2017, the Trust issued 4,000,000 7.250% Series A Trust Preferred Shares (the "Series A Preferred Shares") with a liquidation preference of \$25.00 per share, for gross proceeds of \$100.0 million, or \$96.4 million net of underwriters' discount and issuance costs. When, and if declared by the Company's board of directors, distribution on the Series A Preferred Shares will be payable quarterly on January 30, April 30, July 30, and October 30 of each year, beginning on October 30, 2017, at a rate per annum of 7.250%. Distributions on the Series A Preferred Shares

are discretionary and non-cumulative. The Company has no obligation to pay distributions for a quarterly distribution

30

---

period if the board of directors does not declare the distribution before the scheduled record of date for the period, whether or not distributions are paid for any subsequent distribution periods with respect to the Series A Preferred Shares, or the Trust common shares. If the Company's board of directors does not declare a distribution for the Series A Preferred Shares for a quarterly distribution period, during the remainder of that quarterly distribution period the Company cannot declare or pay distributions on the Trust common shares. The Series A Preferred Shares are not convertible into Trust common shares and have no voting rights, except in limited circumstances as provided for in the share designation for the preferred shares.

#### Profit Allocation Interests

The Allocation Interests represent the original equity interest in the Company. The holders of the Allocation Interests ("Holders") are entitled to receive distributions pursuant to a profit allocation formula upon the occurrence of certain events. The distributions of the profit allocation are paid upon the occurrence of the sale of a material amount of capital stock or assets of one of the Company's businesses ("Sale Event") or, at the option of the Holders, at each five-year anniversary date of the acquisition of one of the Company's businesses ("Holding Event"). The Company records distributions of the profit allocation to the Holders upon occurrence of a Sale Event or Holding Event as distributions declared on Allocation Interests to stockholders' equity when they are approved by the Company's board of directors.

The sale of Fox Factory Holding Corp. ("FOX") shares in March 2017 (refer to Note N - "Investment in FOX") qualified as a Sale Event under the Company's LLC Agreement. In April 2017, with respect to the March 2017 Offering, the Company's board of directors approved and declared a profit allocation payment totaling \$25.8 million that was paid in the second quarter of 2017.

#### Reconciliation of net income (loss) available to common shares of Holdings

The following table reconciles net loss attributable to Holdings to net loss attributable to the common shares of Holdings (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net income (loss) from continuing operations attributable to Holdings	\$4,726	\$7,706	\$312	\$(18,351)
Less: Distributions paid - Allocation Interests	—	—	—	39,120
Less: Distributions paid - Preferred Shares	4,773	—	8,398	—
Less: Accrued distributions - Preferred Shares	1,619	—	1,619	—

Net income (loss) from continuing operations attributable to common shares of Holdings  $(1,666)$   $7,706$   $(9,705)$   $(57,471)$

#### Earnings per share

The Company calculates basic and diluted earnings per share using the two-class method which requires the Company to allocate to participating securities that have rights to earnings that otherwise would have been available only to Trust shareholders as a separate class of securities in calculating earnings per share. The Allocation Interests are considered participating securities that contain participating rights to receive profit allocations upon the occurrence of a Holding Event or Sale Event. The calculation of basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017 reflects the incremental increase during the period in the profit allocation distribution to Holders related to Holding Events.

Basic and diluted earnings per share for the three and nine months ended September 30, 2018 and 2017 attributable to the common shares of Holdings is calculated as follows (in thousands, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
	$(1,666)$	$7,706$	$(9,705)$	$(57,471)$

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Income (loss) from continuing operations attributable to common shares of Holdings				
Less: Effect of contribution based profit - Holding Event	2,404	1,620	3,719	3,954
Income (loss) from continuing operation attributable to common shares of Holdings	\$(4,070)	\$6,086	\$(13,424)	\$(61,425)

31

---



Edgar Filing: Compass Diversified Holdings - Form 10-Q

Income from discontinued operations attributable to common shares of Holdings	\$—	\$—	\$1,165	\$340
Basic and diluted weighted average common shares outstanding	59,900	59,900	59,900	59,900
Basic and fully diluted income (loss) per common share attributable to Holdings				
Continuing operations	\$(0.07)	\$ 0.10	\$(0.22 )	\$(1.03)
Discontinued operations	—	—	0.02	0.01
	\$(0.07)	\$ 0.10	\$(0.20 )	\$(1.02)

Distributions

The following table summarizes information related to our quarterly cash distributions on our Trust common and preferred shares:

Period	Cash Distribution per Share	Total Cash Distributions (in thousands)	Record Date	Payment Date
<b>Trust Common Shares:</b>				
July 1, 2018 - September 30, 2018 <sup>(1)</sup>	\$0.36	\$ 21,564	October 18, 2018	October 25, 2018
April 1, 2018 - June 30, 2018	\$0.36	\$ 21,564	July 19, 2018	July 26, 2018
January 1, 2018 - March 31, 2018	\$0.36	\$ 21,564	April 19, 2018	April 26, 2018
October 1, 2017 - December 31, 2017	\$0.36	\$ 21,564	January 19, 2018	January 25, 2018
July 1, 2017 - September 30, 2017	\$0.36	\$ 21,564	October 19, 2017	October 26, 2017
April 1, 2017 - June 30, 2017	\$0.36	\$ 21,564	July 20, 2017	July 27, 2017
January 1, 2017 - March 31, 2017	\$0.36	\$ 21,564	April 20, 2017	April 27, 2017
October 1, 2016 - December 31, 2016	\$0.36	\$ 21,564	January 19, 2017	January 26, 2017
<b>Series A Preferred Shares:</b>				
July 30, 2018 - October 29, 2018 <sup>(1)</sup>	\$0.453125	\$ 1,813	October 15, 2018	October 30, 2018
April 30, 2018 - July 29, 2018	\$0.453125	\$ 1,813	July 16, 2018	July 30, 2018
January 30, 2018 - April 29, 2018	\$0.453125	\$ 1,813	April 15, 2018	April 30, 2018
October 30, 2017 - January 29, 2018	\$0.453125	\$ 1,813	January 15, 2018	January 30, 2018
June 28, 2017 - October 29, 2017	\$0.61423611	\$ 2,457	October 15, 2017	October 30, 2017
<b>Series B Preferred Shares:</b>				
July 30, 2018 - October 29, 2018 <sup>(1)</sup>	\$0.4921875	\$ 1,969	October 15, 2018	October 30, 2018
March 13, 2018 - July 29, 2018	\$0.74	\$ 2,960	July 16, 2018	July 30, 2018

<sup>(1)</sup> This distribution was declared on October 4, 2018.

Note J — Noncontrolling Interest

Noncontrolling interest represents the portion of the Company's majority owned subsidiary's net income (loss) and equity that is owned by noncontrolling shareholders. The following tables reflect the Company's ownership percentage of its majority owned operating segments and related noncontrolling interest balances as of September 30, 2018 and December 31, 2017:

Edgar Filing: Compass Diversified Holdings - Form 10-Q

	% Ownership <sup>(1)</sup> September 30, 2018		% Ownership <sup>(1)</sup> December 31, 2017	
	Primary	Fully Diluted	Primary	Fully Diluted
5.11 Tactical	97.5	87.7	97.5	85.5
Ergobaby	82.1	76.8	82.7	76.6
Liberty	88.6	85.2	88.6	84.7
Manitoba Harvest	76.6	68.0	76.6	67.0
Velocity Outdoor	99.4	94.2	98.8	89.2
ACI	69.4	69.2	69.4	69.2
Arnold	96.7	79.4	96.7	84.7
Clean Earth	97.5	79.8	97.5	79.8
Foam Fabricators	100.0	91.5	N/a	N/a
Sterno	100.0	88.5	100.0	89.5

(1) The principal difference between primary and diluted percentages of our operating segments is due to stock option issuances of operating segment stock to management of the respective businesses.

(in thousands)	Noncontrolling Interest Balances	
	September 30, 2018	December 31, 2017
5.11 Tactical	\$9,655	\$ 8,003
Ergobaby	25,046	23,416
Liberty	3,348	3,254
Manitoba Harvest	11,507	11,725
Velocity Outdoor	2,458	1,373
ACI	(2,580 )	(5,850 )
Arnold	1,474	1,368
Clean Earth	8,578	7,357
Foam Fabricators	594	—
Sterno	(2,471 )	2,045
Allocation Interests	100	100
	\$57,709	\$ 52,791

Note K — Fair Value Measurement

The following table provides the assets and liabilities carried at fair value measured on a recurring basis at September 30, 2018 and December 31, 2017 (in thousands):

	Fair Value Measurements at September 30, 2018		
	Carrying Value	Level 1	Level 2 Level 3
Liabilities:			
Put option of noncontrolling shareholders <sup>(1)</sup>	\$(178 )	\$ —	\$(178 )
Contingent consideration - acquisition <sup>(2)</sup>	(12,179 )	—	(12,179 )
Interest rate swap	(14 )	—	(14 )
Total recorded at fair value	\$(12,371 )	\$ —	\$(12,357 )

(1) Represents put option issued to noncontrolling shareholders in connection with the 5.11 Tactical and Liberty acquisitions.

(2)

Represents potential earn-out payable by Sterno for the acquisition of Rimports, and Velocity for the acquisition of Ravin.

Fair Value Measurements at  
December 31, 2017

Carrying Value	Level 1	Level 2	Level 3
----------------	---------	---------	---------

## Liabilities:

Put option of noncontrolling shareholders	\$(178 )	—	—	\$(178)
Interest rate swap	(6,107 )	—	(6,107 )	—
Total recorded at fair value	\$(6,285 )	\$	—\$(6,107 )	\$(178)

Reconciliations of the change in the carrying value of the Level 3 fair value measurements from January 1, 2017 through September 30, 2018 are as follows (in thousands):

	Level 3
Balance at January 1, 2017	\$(5,010 )
Contingent consideration - Sterno Home	(382 )
Payment of contingent consideration - Sterno Home	475
Reversal of contingent consideration - Baby Tula	3,780
Reversal of contingent consideration - Sterno Home	956
Change in noncontrolling shareholder put options	3
Balance at January 1, 2018	\$(178 )
Contingent consideration - Rimports <sup>(1)</sup>	(4,100 )
Contingent consideration - Ravin <sup>(2)</sup>	(8,079 )
Balance at September 30, 2018	\$(12,357)

<sup>(1)</sup> The contingent consideration relates to Sterno's acquisition of Rimports in February 2018. The purchase price of Rimports includes a potential earn-out of up to \$25 million contingent on the attainment of certain future performance criteria of Rimports for the twelve-month period from May 1, 2017 to April 30, 2018 and the fourteen month period from March 1, 2018 to April 30, 2019. The fair value of the contingent consideration related to the earn-out was allocated a fair value of \$4.1 million using a probability weighted option pricing model and is recorded as a current liability in the consolidated balance sheet at September 30, 2018.

<sup>(2)</sup> The contingent consideration relates to Velocity's acquisition of Ravin in September 2018. The purchase price of Ravin includes a potential earn-out of up to \$25.0 million contingent on the achievement certain financial metrics for the trailing twelve month period ending December 31, 2018. The fair value of the contingent consideration was calculated based on actual results to date and a forecast for the fourth quarter of 2018.

## Valuation Techniques

## Debt

We classify our fixed and floating rate debt as Level 2 items based on quoted market prices for similar debt issues. In April 2018, the Company issued \$400.0 million aggregate principal amount of its Senior Notes due 2026. The fair value of the Senior Notes was determined based on quoted market prices obtained through an external pricing source which derives its price valuations from daily marketplace transactions, with adjustments to reflect the spreads of benchmark bonds, credit risk and certain other variables. We have determined this to be a Level 2 measurement as all significant inputs into the quote provided by our pricing source are observable in active markets. At September 30, 2018, the carrying value of the principal under the Company's outstanding 2018 Term Loan, including the current portion, was \$497.5 million, which approximates fair value because it has a variable interest rate that reflects market changes in interest rates and changes in the Company's net leverage ratio.

The Company has not changed its valuation techniques in measuring the fair value of any of its other financial assets and liabilities during the period. For details of the Company's fair value measurement policies under the fair value hierarchy, refer to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

## Nonrecurring Fair Value Measurements

The following table provides the assets carried at fair value measured on a non-recurring basis as of December 31, 2017. There were no assets carried at fair value on a non-recurring basis at September 30, 2018.



Edgar Filing: Compass Diversified Holdings - Form 10-Q

(in thousands)	Fair Value Measurements at December 31, 2017			Year ended	
	Carrying Value	Level 1	Level 2	Level 3	Expense
Goodwill - Arnold	\$26,903	—	—	\$26,903	\$ 8,864
Goodwill - Manitoba Harvest	41,024	—	—	41,024	6,188
Tradename - Manitoba Harvest	10,834	—	—	10,834	2,273

Note L — Income taxes

Each fiscal quarter, the Company estimates its annual effective tax rate and applies that rate to its interim pre-tax earnings. In this regard, the Company reflects the full year's estimated tax impact of certain unusual or infrequently occurring items and the effects of changes in tax laws or rates in the interim period in which they occur.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation commonly referred to as the Tax Cuts and Jobs Act of 2017 (the "Tax Act"). The Tax Act reduces the U.S. federal corporate income tax rate from 35% to 21% and requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. The one-time transition tax under the Tax Act is based on earnings and profits ("E&P") that were previously deferred from U.S. income taxes. For the year ended December 31, 2017, the provision for income taxes included provisional tax expense of \$4.9 million related to the one-time transition tax liability of our foreign subsidiaries. The Company has substantially completed the calculation of the total E&P for these foreign subsidiaries although the Company's estimates may be affected as additional regulatory guidance is issued with respect to the Tax Act. Any adjustments to the provisional amounts will be recognized as a component of the provision for income taxes in the period in which such adjustments are determined within the annual period following the enactment of the Tax Act.

The computation of the annual estimated effective tax rate in each interim period requires certain estimates and significant judgment, including the projected operating income for the year, projections of the proportion of income earned and taxed in other jurisdictions, permanent and temporary differences and the likelihood of recovering deferred tax assets generated in the current year. The accounting estimates used to compute the provision for income taxes may change as new events occur, as additional information is obtained or as the tax environment changes. Certain foreign operations are subject to foreign income taxation under existing provisions of the laws of those jurisdictions.

The reconciliation between the Federal Statutory Rate and the effective income tax rate for the nine months ended September 30, 2018 and 2017 is as follows:

	Nine months ended September 30,	
	2018	2017
United States Federal Statutory Rate	21.0 %	(35.0)%
State income taxes (net of Federal benefits)	(4.1 )	(1.0 )
Foreign income taxes	23.1	4.5
Expenses of Compass Group Diversified Holdings LLC representing a pass through to shareholders <sup>(1)</sup>	12.0	0.3
Impairment expense	—	16.9
Effect of loss on equity method investment <sup>(2)</sup>	—	11.0
Impact of subsidiary employee stock options	(8.6 )	2.5
Credit utilization	(6.9 )	(7.7 )
Domestic production activities deduction	—	(2.3 )
Effect of undistributed foreign earnings	—	2.0
Non-recognition of NOL carryforwards at subsidiaries	20.4	(3.5 )
Effect of Tax Act	(3.2 )	—

Other	0.4	1.1
Effective income tax rate	54.1 %	(11.2)%

- (1) The effective income tax rate for the nine months ended September 30, 2018 and 2017 includes a loss at the Company's parent, which is taxed as a partnership.
- (2) The equity method investment was held at the Company's parent, which is taxed as a partnership, resulting in the gain or loss on the investment as a reconciling item in deriving the effective tax rate.

Note M — Defined Benefit Plan

In connection with the acquisition of Arnold, the Company has a defined benefit plan covering substantially all of Arnold's employees at its Lupfig, Switzerland location. The benefits are based on years of service and the employees' highest average compensation during the specific period.

The unfunded liability of \$3.4 million is recognized in the consolidated balance sheet as a component of other non-current liabilities at September 30, 2018. Net periodic benefit cost consists of the following for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Service cost	\$ 135	\$ 134	\$ 403	\$ 401
Interest cost	24	24	72	71
Expected return on plan assets	(39 )	(39 )	(117 )	(117 )
Amortization of unrecognized loss	49	63	148	188
Net periodic benefit cost	\$ 169	\$ 182	\$ 506	\$ 543

During the nine months ended September 30, 2018, Arnold used previously funded contribution reserves to fund the employers' contribution to the pension plan. The total expected contribution by Arnold to the plan will be approximately \$0.6 million, which will be paid using the plan's contribution reserves.

The plan assets are pooled with assets of other participating employers and are not separable; therefore, the fair values of the pension plan assets at September 30, 2018 were considered Level 3.

Note N - Investment in FOX

FOX, a former majority owned subsidiary of the Company that is publicly traded on the NASDAQ Stock Market under the ticker "FOXF," is a designer, manufacturer and marketer of high-performance ride dynamic products used primarily for bicycles, side-by-side vehicles, on-road vehicles with off-road capabilities, off-road vehicles and trucks, all-terrain vehicles, snowmobiles, specialty vehicles and applications, and motorcycles. The Company held a 14% ownership interest as of January 1, 2017. The investment in FOX was accounted for using the fair value option. In March 2017, FOX closed on a secondary public offering (the "March 2017 Offering") through which the Company sold their remaining 5,108,718 shares in FOX for total net proceeds of \$136.1 million. Subsequent to the March 2017 Offering, the Company no longer holds an ownership interest in FOX.

Note O - Commitments and Contingencies

In the normal course of business, the Company and its subsidiaries are involved in various claims and legal proceedings. While the ultimate resolution of these matters has yet to be determined, the Company does not believe that any unfavorable outcomes will have a material adverse effect on the Company's consolidated financial position or results of operations.

Note P — Related Party Transactions

Integration Services Agreements

Foam Fabricators, which was acquired in 2018, and Velocity Outdoor, which was acquired in 2017, entered into Integration Services Agreements ("ISA") with CGM. The ISA provides for CGM to provide services for new platform acquisitions to, amongst other things, assist the management at the acquired entities in establishing a corporate governance program, implement compliance and reporting requirements of the Sarbanes-Oxley Act of 2002, as amended, and align the acquired entity's policies and procedures with our other subsidiaries. Each ISA is for the twelve month period subsequent to the acquisition. Velocity Outdoor paid CGM \$0.75 million in integration services



fees during 2017 and \$0.75 million in integration services fees in 2018. Foam Fabricators will pay CGM \$2.25 million over the term of the ISA, \$2.0 million in 2018 and \$0.25 million in 2019. Integration services fees are included in selling, general and administrative expense on the subsidiaries' statement of operations in the period in which they are incurred.

The Company and its businesses have the following significant related party transactions:

**Sterno Recapitalization**

In January 2018, the Company completed a recapitalization at Sterno whereby the Company entered into an amendment to the intercompany loan agreement with Sterno (the "Sterno Loan Agreement"). The Sterno Loan Agreement was amended to (i) provide for term loan borrowings of \$57.7 million to fund a distribution to the Company, which owned 100% of the outstanding equity of Sterno at the time of the recapitalization, and (ii) extend the maturity dates of the term loans. In connection with the recapitalization, Sterno's management team exercised all of their vested stock options, which represented 58,000 shares of Sterno. The Company then used a portion of the distribution to repurchase the 58,000 shares from management for a total purchase price of \$6.0 million. In addition, Sterno issued new stock options to replace the exercised options, thus maintaining the same percentage of fully diluted non-controlling interest that existed prior to the recapitalization.

**5.11**

Related Party Vendor Purchases - 5.11 purchases inventory from a vendor who is a related party to 5.11 through one of the executive officers of 5.11 via the executive's 40% ownership interest in the vendor. During the three and nine months ended September 30, 2018, 5.11 purchased approximately \$0.9 million and \$2.9 million, respectively, in inventory from the vendor.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Item 2 contains forward-looking statements. Forward-looking statements in this Quarterly Report on Form 10-Q are subject to a number of risks and uncertainties, some of which are beyond our control. Our actual results, performance, prospects or opportunities could differ materially from those expressed in or implied by the forward-looking statements. Additional risks of which we are not currently aware or which we currently deem immaterial could also cause our actual results to differ, including those discussed in the section entitled "Forward-Looking Statements" included elsewhere in this Quarterly Report on Form 10-Q as well as those risk factors discussed in the section entitled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 and in the section entitled "Risk Factors" in Part II, Item 1A of this Quarterly Report on Form 10-Q.

### Overview

Compass Diversified Holdings ("Holdings") was incorporated in Delaware on November 18, 2005. Compass Group Diversified Holdings LLC (the "Company") was also formed on November 18, 2005. Holdings and the Company (collectively "CODI") were formed to acquire and manage a group of small and middle-market businesses headquartered in North America. The Company is the operating entity and is a controlling owner of ten businesses, or operating segments, at September 30, 2018. The segments are as follows: 5.11 Acquisition Corp. ("5.11" or "5.11 Tactical"), Velocity Outdoor, Inc. (formerly "Crosman Corp.") ("Velocity Outdoor" or "Velocity"), The Ergo Baby Carrier, Inc. ("Ergobaby"), Liberty Safe and Security Products, Inc. ("Liberty Safe" or "Liberty"), Fresh Hemp Foods Ltd. ("Manitoba Harvest"), Compass AC Holdings, Inc. ("ACI" or "Advanced Circuits"), AMT Acquisition Corporation ("Arnold"), Clean Earth Holdings, Inc. ("Clean Earth"), FFI Compass, Inc. ("Foam Fabricators" or "Foam") and Sterno Products, LLC ("Sterno").

We acquired our existing businesses (segments) at September 30, 2018 as follows:

Business	Acquisition Date	Ownership Interest - September 30, 2018	
		Primary	Diluted
Advanced Circuits	May 16, 2006	69.4%	69.2%
Liberty Safe	March 31, 2010	88.6%	85.2%
Ergobaby	September 16, 2010	82.1%	76.8%
Arnold	March 5, 2012	96.7%	79.4%
Clean Earth	August 7, 2014	97.5%	79.8%
Sterno	October 10, 2014	100.0%	88.5%
Manitoba Harvest	July 10, 2015	76.6%	68.0%
5.11 Tactical	August 31, 2016	97.5%	87.7%
Velocity Outdoor	June 2, 2017	99.4%	94.2%
Foam Fabricators	February 15, 2018	100.0%	91.5%

We categorize the businesses we own into two separate groups of businesses: (i) branded consumer businesses, and (ii) niche industrial businesses. Branded consumer businesses are characterized as those businesses that we believe capitalize on a valuable brand name in their respective market sector. We believe that our branded consumer businesses are leaders in their particular product category. Niche industrial businesses are characterized as those businesses that focus on manufacturing and selling particular products and industrial services within a specific market sector. We believe that our niche industrial businesses are leaders in their specific market sector. The following is an overview of each of our businesses:

### Branded Consumer

5.11 Tactical - 5.11 is a leading provider of purpose-built tactical apparel and gear for law enforcement, firefighters, EMS, and military special operations as well as outdoor and adventure enthusiasts. 5.11 is a brand known for innovation and authenticity, and works directly with end users to create purpose-built apparel and gear designed to enhance the safety, accuracy, speed and performance of tactical professionals and enthusiasts worldwide. 5.11 operates sales offices and distribution centers globally, and 5.11 products are widely distributed in uniform stores,

military exchanges, outdoor retail stores, its own retail stores and on 511tactical.com.

38

---

**Velocity Outdoor** - Velocity Outdoor is a leading designer, manufacturer, and marketer of airguns, archery products, laser aiming devices and related accessories. Velocity Outdoor offers its products under the highly recognizable Crosman, Benjamin, LaserMax, Ravin and CenterPoint brands that are available through national retail chains, mass merchants, dealer and distributor networks. Airguns historically represent Velocity Outdoor's largest product category, with more than 50% of gross sales. The airgun product category consists of air rifles, air pistols and a range of accessories including targets, holsters and cases. Velocity Outdoor's other primary product categories are archery, with products including CenterPoint crossbows and the Pioneer Airbow, consumables, which includes steel and plastic BBs, lead pellets and CO2 cartridges, lasers for firearms, and airsoft products. In September 2018, Velocity acquired Ravin Crossbows LLC ("Ravin"), a manufacturer and innovator of crossbows and accessories. Ravin primarily focuses on the higher-end segment of the crossbow market and has developed significant intellectual property related to the advancement of crossbow technology.

**Ergobaby** - Ergobaby is a designer, marketer and distributor of wearable baby carriers and accessories, blankets and swaddlers, nursing pillows, and related products. In May 2016, Ergobaby acquired New Baby Tula LLC ("Baby Tula"), a maker of premium carriers, slings, blankets and wraps. Ergobaby primarily sells its Ergobaby and Baby Tula branded products through brick-and-mortar retailers, national chain stores, online retailers, its own websites and distributors. Historically, Ergobaby derives more than 50% of its sales from outside of the United States.

**Liberty** - Founded in 1988, Liberty Safe is the premier designer, manufacturer and marketer of home and gun safes in North America. From its over 300,000 square foot manufacturing facility, Liberty Safe produces a wide range of home and gun safe models in a broad assortment of sizes, features and styles ranging from an entry level product to good, better and best products. Products are marketed under the Liberty brand, as well as a portfolio of licensed and private label brands, including Cabela's, Case IH, Colt and John Deere. Liberty Safe's products are the market share leader and are sold through an independent dealer network ("Dealer sales") in addition to various sporting goods, farm and fleet and home improvement retail outlets ("Non-Dealer sales"). Liberty has the largest independent dealer network in the industry.

**Manitoba Harvest** - Headquartered in Winnipeg, Manitoba, Manitoba Harvest is a pioneer and leader in branded, hemp-based foods and ingredients. Manitoba Harvest's products, which management believes are one of the fastest growing in the hemp food market and among the fastest growing in the natural foods industry, are currently carried in approximately 13,000 retail stores across the United States and Canada. The company's hemp-based, 100% all-natural consumer products include hemp hearts, protein powder, hemp oil and snacks.

#### **Niche Industrial**

**Advanced Circuits** - Advanced Circuits is a provider of small-run, quick-turn and volume production printed circuit boards ("PCBs") to customers throughout the United States. Historically, small-run and quick-turn PCBs have represented approximately 54% of Advanced Circuits' gross sales. Small-run and quick-turn PCBs typically command higher margins than volume production PCBs given that customers require high levels of responsiveness, technical support and timely delivery of small-run and quick-turn PCBs and are willing to pay a premium for them. Advanced Circuits is able to meet its customers' demands by manufacturing custom PCBs in as little as 24 hours, while maintaining over 98.0% error-free production rates and real-time customer service and product tracking 24 hours per day.

**Arnold** - Arnold is a global manufacturer of engineered magnetic solutions for a wide range of specialty applications and end-markets, including aerospace and defense, motorsport/automotive, oil and gas, medical, general industrial, electric utility, reprographics and advertising specialty markets. Arnold produces high performance permanent magnets (PMAG), precision foil products (Precision Thin Metals or "PTM"), and flexible magnets (Flexmag™) that are mission critical in motors, generators, sensors and other systems and components. Based on its long-term relationships, Arnold has built a diverse and blue-chip customer base totaling more than 2,000 clients worldwide. Arnold is headquartered in Rochester, New York.

**Clean Earth** - Founded in 1990, Clean Earth is a provider of environmental services for a variety of contaminated materials. Clean Earth provides a one-stop shop solution that analyzes, treats, documents and recycles waste streams generated in multiple end-markets such as power, construction, commercial development, oil and gas, medical, infrastructure, industrial and dredging. Historically, the majority of Clean Earth's revenues have been generated by contaminated soils, which includes environmentally impacted soils, drill cuttings and other materials which are treated

at one of its eleven permitted soil treatment facilities. Clean Earth also operates six RCRA Part B hazardous waste facilities, and a water waste treatment facility. The remaining revenue has been generated by dredge material, which consists of sediment removed from the floor of a body of water for navigational purposes and/or environmental remediation of contaminated waterways and is treated at one of its two permitted dredge processing facilities.

Approximately 98% of the material processed by Clean Earth is beneficially reused for such purposes as daily landfill cover, industrial and brownfield redevelopment projects.

Foam Fabricators - Founded in 1957 and headquartered in Scottsdale, Arizona, Foam Fabricators is a designer and manufacturer of custom molded protective foam solutions and original equipment manufacturer (OEM) components made from expanded polystyrene (EPS) and expanded polypropylene (EPP). Foam Fabricators operates 13 molding and fabricating facilities across North America and provides products to a variety of end-markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building products and others.

Sterno - Sterno is a manufacturer and marketer of portable food warming fuel and creative ambience solutions for the hospitality and consumer markets. Sterno offers a broad range of wick and gel chafing fuels, butane stoves and accessories, liquid and traditional wax candles, catering equipment and lamps through their Sterno Products division. In January 2016, Sterno acquired Northern International, Inc. ("Sterno Home"), which sells flameless candles and outdoor lighting products through the retail segment, and in February 2018 Sterno acquired Rimports, which is a manufacturer and distributor of branded and private label scented wax cubes and warmer products used for home decor and fragrance systems.

Our management team's strategy for our businesses involves:

- utilizing structured incentive compensation programs tailored to each business to attract, recruit and retain talented managers to operate our businesses;
- regularly monitoring financial and operational performance, instilling consistent financial discipline, and supporting management in the development and implementation of information systems to effectively achieve these goals;
- assisting management in their analysis and pursuit of prudent organic cash flow growth strategies (both revenue and cost related);
- identifying and working with management to execute attractive external growth and acquisition opportunities; and
- forming strong subsidiary level boards of directors to supplement management in their development and implementation of strategic goals and objectives.

While our businesses have different growth opportunities and potential rates of growth, we work with the management teams of each of our businesses to increase the value of, and cash generated by, each business through various initiatives, including making selective capital investments to expand geographic reach, increase capacity or reduce manufacturing costs of our businesses; improving and expanding existing sales and marketing programs; and assisting in the acquisition and integration of complementary businesses.

We remain focused on marketing our Company's attractive ownership and management attributes to potential sellers of middle market businesses. In addition, we continue to pursue opportunities for add-on acquisitions by our existing subsidiary companies, which can be particularly attractive from a strategic perspective. Middle market deal flow has remained consistent in 2018, with valuation levels remaining high, driven by the availability of debt capital with favorable terms and financial and strategic buyers seeking to deploy available equity capital.

#### Recent Events

##### Senior Notes and 2018 Credit Facility

On April 18, 2018, we consummated the issuance and sale of \$400.0 million aggregate principal amount of its 8.000% Senior Notes due 2026 (the "Notes" or "Senior Notes") offered pursuant to a private offering. We used the net proceeds from the sale of the Notes to repay debt under our existing credit facilities in connection with a concurrent refinancing of our 2014 Credit Facility. The Notes will bear interest at the rate of 8.000% per annum and will mature on May 1, 2026. Interest on the Notes is payable in cash on May 1st and November 1st of each year, beginning on November 1, 2018. The Notes are general senior unsecured obligations and are not guaranteed by our subsidiaries.

Concurrent with the issuance of the Notes, we entered into an Amended and Restated Credit Agreement (the "2018 Credit Facility") to amend and restate the 2014 Credit Facility, originally dated as of June 6, 2014 (as previously amended) among the Company, the lenders from time to time party thereto (the "Lenders"), and Bank of America, N.A., as Administrative Agent. The 2018 Credit Facility provides for (i) revolving loans, swing line loans and letters of credit (the "2018 Revolving Credit Facility") up to a maximum aggregate amount of \$600 million, and (ii) a \$500 million term loan (the "2018 Term Loan"). The 2018 Term Loan was issued at an original issuance discount of 99.75%. We used the proceeds from the 2018 Credit Facility and the proceeds from the Notes offering to pay all amounts outstanding





under our existing credit agreement and to pay the fees, original issue discount and expenses incurred in connection with the 2018 Credit Facility and Notes.

#### Trust Preferred Share Issuance

On March 13, 2018, the Trust issued 4,000,000 7.875% Series B Trust Preferred Shares (the "Series B Preferred Shares") for gross proceeds of \$100.0 million, or \$96.5 million net of underwriters' discount and issuance costs. Distributions on the Series B Preferred Shares will be payable quarterly in arrears, when and as declared by the Company's board of directors on January 30, April 30, July 30, and October 30 of each year, beginning on July 30, 2018. Distributions on the Series B Preferred Shares are cumulative.

#### Acquisition of Foam Fabricators

On February 15, 2018, the Company, through a wholly owned subsidiary FFI Compass, Inc., acquired all of the issued and outstanding capital stock of Foam Fabricators, Inc., a Delaware corporation ("Foam Fabricators"), for a purchase price of approximately \$250.3 million. Foam Fabricators is a leading designer and manufacturer of custom molded protective foam solutions and OEM components made from expanded polymers such as expanded polystyrene and expanded polypropylene. Founded in 1957 and headquartered in Scottsdale, Arizona, it operates 13 molding and fabricating facilities across North America and provides products to a variety of end-markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building products and others. We funded our acquisition of Foam Fabricators with a draw on our 2014 Revolving Credit Facility.

#### Acquisition of Rimports

On February 26, 2018, our Sterno subsidiary acquired all of the issued and outstanding capital stock of Rimports, Inc., a Utah corporation ("Rimports"), pursuant to a Stock Purchase Agreement, dated January 23, 2018. Sterno purchased a 100% controlling interest in Rimports. Headquartered in Provo, Utah, Rimports is a manufacturer and distributor of branded and private label scented wickless candle products used for home décor and fragrance. Rimports offers an extensive line of wax warmers, scented wax cubes, essential oils and diffusers, and other home fragrance systems, through the mass retailer channel. The purchase price, net of transaction costs, was approximately \$149.8 million, subject to any working capital adjustment. The purchase price of Rimports includes a potential earn-out of up to \$25 million contingent on the attainment of certain future performance criteria of Rimports. Sterno funded the acquisition through their intercompany credit facility with the Company.

#### Acquisition of ESMI

On May 23, 2018, Clean Earth acquired all of the outstanding capital stock of Environmental Soil Management, Inc. ("ESMI"), located in Fort Edward, New York and Loudon, New Hampshire. The acquisition provided Clean Earth the opportunity to geographically expand their soil and hazardous waste solutions in the New York and New England market. The purchase price was approximately \$30.7 million.

#### Acquisition of Ravin

On September 4, 2018, Velocity Outdoor (formerly "Crosman Corp.") acquired all of the outstanding membership interests in Ravin for a purchase price of approximately \$98.0 million, net of transaction costs, plus a potential earn-out of up to \$25.0 million based on gross profit levels as of December 31, 2018. Headquartered in Superior, Wisconsin, Ravin Crossbows is a leading designer, manufacturer and innovator of crossbows and accessories. Ravin primarily focuses on the higher-end segment of the crossbow market and has developed significant intellectual property related to the advancement of crossbow technology. The acquisition of Ravin positions Velocity Outdoor to more fully capitalize on the sizeable crossbow market, further diversify its customer base and take advantage of the product and market expertise inside of Ravin.

#### Non-GAAP Financial Measures

"U.S. GAAP" or "GAAP" refer to generally accepted accounting principles in the United States. A non-GAAP financial measure is a numerical measure of historical or future performance, financial position or cash flow that excludes amounts, or is subject to adjustments that effectively exclude amounts, included in the most directly comparable measure calculated and presented in accordance with GAAP in our financial statements, and vice versa for measures that include amounts, or are subject to adjustments that effectively include amounts, that are excluded from the most directly comparable measure as calculated and presented. Our Manitoba Harvest acquisition uses the Canadian Dollar as its functional currency. We will periodically refer to net sales and net sales growth rates in the

Manitoba Harvest management's discussion and analysis on a "constant currency" basis so that the business results can be viewed

41

---

without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons of Manitoba Harvest's business performance. "Constant currency" net sales results are calculated by translating current period net sales in local currency using the prior year's currency conversion rate. Generally, when the dollar either strengthens or weakens against other currencies, the growth at constant currency rates or adjusting for currency will be higher or lower than growth reported at actual exchange rates. "Constant currency" measured net sales is not a measure of net sales presented in accordance with U.S. GAAP.

#### Results of Operations

The following discussion reflects a comparison of the historical results of operations of our consolidated business for the three and nine months ended September 30, 2018 and September 30, 2017, and components of the results of operations as well as those components presented as a percent of net revenues, for each of our businesses on a stand-alone basis. For the 2018 acquisitions of Foam Fabricators and Rimports, the pro forma results of operations have been prepared as if we purchased these businesses on January 1, 2017. The historical operating results of Rimports prior to acquisition have been added to the previously reported Sterno results of operations for the three and nine months ended September 30, 2017, and the Rimports results of operations for the 2018 period prior to acquisition by Sterno on February 26, 2018 have been added to the results of operations of Sterno for the three and nine months ended September 30, 2018 for comparability purposes. For the 2017 acquisition of Velocity Outdoor, the following discussion reflects pro forma results of operations for the nine months ended September 30, 2017 as if we had acquired Velocity January 1, 2017. Where appropriate, relevant pro forma adjustments are reflected as part of the historical operating results. We believe this is the most meaningful comparison of the operating results for each of our business segments. The following results of operations at each of our businesses are not necessarily indicative of the results to be expected for a full year.

All dollar amounts in the financial tables are presented in thousands. References in the financial tables to percentage changes that are not meaningful are denoted by "NM."

Three months ended September 30, 2018 compared to three months ended September 30, 2017

#### Consolidated

The following table sets forth our unaudited results of operations for the three months ended September 30, 2018 and 2017:

	Three months ended	
	September 30, 2018	September 30, 2017
Net revenues	\$448,700	\$323,957
Cost of revenues	298,996	206,232
Gross profit	149,704	117,725
Selling, general and administrative expense	96,906	80,804
Fees to manager	10,982	8,277
Amortization of intangibles	17,562	14,167
Operating income	24,254	14,477
Interest expense	(15,699 )	(6,945 )
Amortization of debt issuance costs	(927 )	(1,004 )
Other income (expense)	492	2,020
Income from continuing operations before income taxes	8,120	8,548
Provision for income taxes	2,354	192
Income from continuing operations	\$5,766	\$8,356

#### Net revenues

On a consolidated basis, net revenues for the three months ended September 30, 2018 increased by approximately \$124.7 million, or 38.5%, compared to the corresponding period in 2017. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$33.3 million and \$50.4 million, respectively, to the increase in net revenues. During the three months ended September 30, 2018 compared to 2017, we also saw notable revenue increases at



Clean Earth (\$15.4 million increase due to improved performance across each of Clean Earth's service lines as well as add-on acquisitions in the current year), 5.11 (\$11.3 million increase), Manitoba Harvest (\$3.4 million increase), Arnold (\$3.4 million increase) and our legacy Sterno business, exclusive of Rimports (\$10.7 million) partially offset by a decrease in sales at our Ergobaby business (\$3.6 million decrease). Refer to "Results of Operations - Business Segments" for a more detailed analysis of net revenues by business segment.

We do not generate any revenues apart from those generated by the businesses we own. We may generate interest income on the investment of available funds, but we expect such earnings to be minimal. Our investment in our businesses is typically in the form of loans from the Company to such businesses, as well as equity interests in those companies. Cash flows coming to the Trust and the Company are the result of interest payments on those loans, amortization of those loans and dividends on our equity ownership. However, on a consolidated basis, these items will be eliminated.

#### Cost of revenues

On a consolidated basis, cost of revenues increased approximately \$92.8 million during the three-month period ended September 30, 2018 compared to the corresponding period in 2017. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$23.9 million and \$38.5 million, respectively, to the increase. Clean Earth's cost of revenue increased \$12.7 million, in line with the increase in revenues in the third quarter of 2018, 5.11's cost of sales increased \$5.9 million as compared to the cost of sales during the corresponding period in 2017, and our legacy Sterno business had an increase in cost of sales of \$5.2 million. Gross profit as a percentage of net revenues was approximately 33.4% in the three months ended September 30, 2018 compared to 36.3% in the three months ended September 30, 2017. Refer to "Results of Operations - Business Segments" for a more detailed analysis of gross profit by business segment.

#### Selling, general and administrative expense

Consolidated selling, general and administrative expense increased approximately \$16.1 million during the three-month period ended September 30, 2018, compared to the corresponding period in 2017. The increase in selling, general and administrative expense in the third quarter of 2018 compared to 2017 is principally the result of the acquisition of Foam Fabricators (\$3.1 million increase) and Rimports (\$2.9 million increase), as well as notable increases at 5.11 Tactical (\$3.4 million increase) and Clean Earth (\$3.8 million increase). Refer to "Results of Operations - Business Segments" for a more detailed analysis of selling, general and administrative expense by business segment. At the corporate level, general and administrative expense was \$2.7 million in the third quarter of 2018 and \$2.8 million in the third quarter of 2017.

#### Fees to manager

Pursuant to the Management Services Agreement ("MSA"), we pay CGM a quarterly management fee equal to 0.5% (2.0% annually) of our consolidated adjusted net assets. We accrue for the management fee on a quarterly basis. For the three months ended September 30, 2018, we incurred approximately \$11.0 million in management fees as compared to \$8.3 million in fees in the three months ended September 30, 2017. The increase was the result of our Foam Fabricators and Rimports acquisitions in February 2018.

#### Amortization expense

Amortization expense for the three months ended September 30, 2018 increased \$3.4 million as compared to the three months ended September 30, 2017 primarily as a result of the acquisition of Foam Fabricators and Rimports in February 2018, and add-on acquisitions in the current year at Clean Earth.

#### Interest Expense

We recorded interest expense totaling \$15.7 million for the three months ended September 30, 2018 compared to \$6.9 million for the comparable period in 2017, an increase of \$8.8 million. The increase in interest expense for the quarter reflects the interest associated with the issuance of our Senior Notes in April 2018, as well as an increase of the amount outstanding under our revolving credit facility as a result of add-on acquisitions made during the third quarter of 2018. The first payment of interest on the Senior Notes will be in November 2018, and for the third quarter of 2018, we recorded \$8.0 million in interest expense in connection with the Senior Notes.

#### Income Taxes

We had an income tax provision of \$2.4 million with an effective income tax rate of 29% during the three months ended September 30, 2018 compared to an income tax provision of \$0.2 million with an effective income tax rate of

2.2%

43

---

during the same period in 2017. In December 2017, the U.S. government enacted the Tax Cuts and Jobs Act (the "Tax Act") which made broad and complex changes to the U.S. tax code. Among other changes of the Tax Act, the tax rate on corporations was reduced from 35% to 21%; a limitation on the deduction of interest expense was enacted, certain tangible property acquired after September 2017 will qualify for 100% expensing, U.S federal income tax on foreign earnings was eliminated (subject to certain exceptions) and a new base erosion anti-tax abuse tax were added. Although the Company is treated as a partnership for U.S. federal income tax purposes, each of our businesses was affected by the Tax Act. While our earnings before taxes for the quarter ended September 30, 2018 decreased by approximately \$0.4 million, the effect of foreign, state and local taxes at our subsidiaries increased the effective tax rate during the quarter.

## Branded Consumer Businesses

### 5.11 Tactical

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$83,342	100.0 %	\$72,005	100.0 %
Gross profit	\$39,969	48.0 %	\$34,553	48.0 %
SG&A	\$35,792	42.9 %	\$32,370	45.0 %
Operating income (loss)	\$1,740	2.1 %	\$(253 )	(0.4 )%

#### Net sales

Net sales for the three months ended September 30, 2018 were \$83.3 million as compared to net sales of \$72.0 million for the three months ended September 30, 2017, an increase of \$11.3 million, or 15.7%. This increase is due primarily to retail and e-commerce sales growth of \$5.3 million or 44%, driven by growing demand in direct to consumer channels. Retail sales grew largely due to twenty-eight new retail store openings since September 2017 (bringing the total store count to forty-two as of September 30, 2018). The increase in net sales for the three months ended September 30, 2018 as compared to the corresponding period in the prior year was offset by a \$0.7 million decline in Direct-to-Agency sales.

#### Gross profit

Gross profit as a percentage of net sales was 48.0% in both the three months ended September 30, 2018 and September 30, 2017, with the increase in cost of goods sold consistent with the increase in net sales.

#### Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 was \$35.8 million, or 42.9% of net sales compared to \$32.4 million, or 45.0% of net sales for the comparable period in 2017. The decrease in selling, general and administrative expense as a percentage of net sales was primarily due to reduction in spend, primarily in the areas of travel and marketing.

#### Income (loss) from operations

Income from operations for the three months ended September 30, 2018 was \$1.7 million, an increase of \$2.0 million when compared to a loss from operations of \$0.3 million for the same period in 2017, based on the factors described above.

## Ergobaby

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$24,260	100.0 %	\$27,835	100.0 %
Gross profit	\$16,028	66.1 %	\$18,832	67.7 %
SG&A	\$9,890	40.8 %	\$9,973	35.8 %
Operating income	\$4,191	17.3 %	\$5,884	21.1 %





Net sales

Net sales for the three months ended September 30, 2018 were \$24.3 million, a decrease of \$3.6 million, or 12.8%, compared to the same period in 2017. Net sales from Baby Tula for each of the third quarters of 2018 and 2017 were \$4.8 million. During the three months ended September 30, 2018, international sales were approximately \$16.1 million, representing a decrease of \$1.0 million over the corresponding period in 2017, primarily as a result of decreased sales volume at Ergobaby's Asia-Pacific distributors. Domestic sales were \$8.1 million in the third quarter of 2018, reflecting a decrease of \$2.7 million compared to the corresponding period in 2017. The decrease in domestic sales was primarily the result of the continued effect of the bankruptcy of a large national retail customer that began in the third quarter of 2017 as well as one-time favorable credit adjustments in the prior year quarter.

Gross profit

Gross profit as a percentage of net sales was 66.1% for the quarter ended September 30, 2018, as compared to 67.7% for the three months ended September 30, 2017. The decrease in gross profit was due to increased production costs as a result of the stroller launch and increased chargebacks during the quarter.

Selling, general and administrative expense

Selling, general and administrative expense was consistent quarter over quarter, with expense of \$9.9 million, or 40.8% of net sales for the three months ended September 30, 2018 as compared to \$10.0 million or 35.8% of net sales for the same period of 2017. The increase in selling, general and administrative expense as a percentage of net sales in the three months ended September 30, 2018 as compared to the comparable period in the prior year is due to the decline in distributor revenue which has minimal associated costs.

Income from operations

Income from operations for the three months ended September 30, 2018 decreased \$1.7 million, compared to the same period of 2017, based on the factors noted above.

Liberty Safe

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$17,872	100.0 %	\$18,423	100.0 %
Gross profit	\$4,062	22.7 %	\$5,397	29.3 %
SG&A	\$3,452	19.3 %	\$3,204	17.4 %
Operating income	\$467	2.6 %	\$2,050	11.1 %

Net sales

Net sales for the quarter ended September 30, 2018 decreased approximately \$0.6 million, or 3.0%, to \$17.9 million, compared to the corresponding quarter ended September 30, 2017. Non-Dealer sales were approximately \$7.0 million in the three months ended September 30, 2018 compared to \$7.9 million for the three months ended September 30, 2017, representing a decrease of \$0.9 million, or 11.4%. Dealer sales totaled approximately \$10.8 million in the three months ended September 30, 2018 compared to \$10.5 million in the same period in 2017, representing an increase of \$0.3 million or 2.9%.

Gross profit

Gross profit as a percentage of net sales totaled approximately 22.7% and 29.3% for the quarters ended September 30, 2018 and September 30, 2017, respectively. The decrease in gross profit as a percentage of net sales during the three months ended September 30, 2018 compared to the same period in 2017 is primarily attributable to cost increases in raw materials. Liberty has continued to see a rise in raw material costs, particularly the cost of steel, during 2018 as the tariffs on imported steel has led to rising domestic steel prices. On average, materials account for approximately 60% of the total costs of a safe, with steel accounting for 40% of material costs.

Selling, general and administrative expense

Selling, general and administrative expense was \$3.5 million for the three months ended September 30, 2018 compared to \$3.2 million for the three months ended September 30, 2017. The increase in selling, general and administrative expense during the current quarter is primarily related to increased co-op advertising expense for national accounts. Selling, general and administrative expense represented 19.3% of net sales in 2018 and 17.4% of net sales for the same period of 2017.

Income from operations

Income from operations decreased \$1.6 million during the three months ended September 30, 2018 to \$0.5 million, compared to the corresponding period in 2017. This decrease was primarily a result of the decrease in gross profit for the quarter, for the reasons noted above.

Manitoba Harvest

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$17,300	100.0 %	\$13,948	100.0 %
Gross profit	\$7,098	41.0 %	\$6,156	44.1 %
SG&A	\$6,770	39.1 %	\$5,065	36.3 %
Operating loss	\$(885 )	(5.1 )%	\$(169 )	(1.2 )%

Net sales

Net sales for the three months ended September 30, 2018 were \$17.3 million as compared to \$13.9 million for the three months ended September 30, 2017, an increase of \$3.4 million, or 24.0%. During the third quarter of 2018, Manitoba Harvest continued to deliver strong growth in their branded product segment driven by new distribution gains, national hemp seed promotions with key retailers, new product innovation, and consumer awareness initiatives. The company's ingredients product segment posted strong overall growth for the most recent quarter, driven by their hemp protein and oil product lines.

Gross profit

Gross profit for the three months ended September 30, 2018 was approximately \$7.1 million compared to approximately \$6.2 million for the same period in 2017. Gross profit as a percentage of net sales was 41.0% in the quarter ended September 30, 2018 and 44.1% in the quarter ended September 30, 2017. The decrease in gross profit as a percentage of net sales in the third quarter of 2018 as compared to the same quarter in the prior year is primarily attributable a one-time promotion with a key retailer that led to higher production and logistics costs.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 was approximately \$6.8 million as compared to \$5.1 million in the quarter ended September 30, 2017, an increase of \$1.7 million driven by investments in sales and marketing initiatives. Selling, general and administrative expense as a percentage of net sales in the three months ended September 30, 2018 increased compared to the same period in 2017, representing 39.1% of net sales in the third quarter of 2018 as compared to 36.3% of net sales for the same period in 2017.

Loss from operations

Manitoba Harvest had a loss from operations for the three months ended September 30, 2018 of \$0.9 million, as compared to a loss from operations of \$0.2 million for the quarter ended September 30, 2017, an increase of \$0.7 million, based on the factors described above.

## Velocity Outdoor

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$34,289	100.0 %	\$34,449	100.0 %
Gross profit	\$9,171	26.7 %	\$5,415	15.7 %
SG&A	\$5,993	17.5 %	\$5,121	14.9 %
Operating income (loss)	\$1,833	5.3 %	\$(1,388)	(4.0) %

## Net sales

Net sales for the three months ended September 30, 2018 were \$34.3 million, a decrease of \$0.2 million or 0.5%, compared to the same period in 2017. Net sales of Ravin included in the third quarter of 2018 were \$4.4 million. Excluding the net sales from Ravin, the decline in net sales for the three months ended September 30, 2018 is primarily due to softness in core airgun and archery product lines as a result of a decline in the outdoor sporting market.

## Gross profit

Gross profit as a percentage of net sales was 26.7% for the three months ended September 30, 2018 as compared to 15.7% in the three months ended September 30, 2017. The cost of goods sold for the quarter ended September 30, 2017 included expense of \$3.2 million reflecting the impact of the inventory step-up expense resulting from our acquisition of Velocity in June 2017. Excluding the effect of the amortization of the inventory step-up in the prior year, gross profit as a percentage of net sales in the third quarter of 2017 was 25.1%.

## Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 was \$6.0 million, or 17.5% of net sales compared to \$5.1 million, or 14.9% of net sales for the three months ended September 30, 2017. The selling, general and administrative expense for the three months ended September 30, 2018 included \$1.3 million in transaction costs related to the acquisition of Ravin in September 2018, while the third quarter of 2017 included \$0.4 million in integration service fees paid to CGM. The remaining expense variance, after consideration of the Ravin acquisition costs, is related to cost containment activities and the end of the integration fees paid to CGM.

## Income (loss) from operations

Income from operations for the three months ended September 30, 2018 was \$1.8 million, an increase of \$3.2 million when compared to a loss from operations of \$1.4 million for the same period in 2017, based on the factors described above.

## Niche Industrial Businesses

## Advanced Circuits

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$23,424	100.0 %	\$22,436	100.0 %
Gross profit	\$11,067	47.2 %	\$10,299	45.9 %
SG&A	\$3,739	16.0 %	\$3,673	16.4 %
Operating income	\$6,902	29.5 %	\$6,191	27.6 %

## Net sales

Net sales for the three months ended September 30, 2018 were \$23.4 million, an increase of approximately \$1.0 million compared to the three months ended September 30, 2017. The increase in net sales was due to increased sales in their Quick-Turn Production PCBs, Long-Lead Time PCBs, Subcontract PCBs, partially offset by decreased sales in Assembly by approximately \$0.5 million. Quick-Turn Small-Run PCBs comprised approximately 19.6% of gross sales and Quick-Turn Production PCBs represented approximately 33.3% of gross sales for the third quarter of 2018. Quick-Turn Small-Run PCBs comprised approximately 20.2% of gross sales and Quick-Turn Production PCBs represented approximately 32.4% of gross sales for the third quarter 2017.



## Edgar Filing: Compass Diversified Holdings - Form 10-Q

### Gross profit

Gross profit as a percentage of net sales increased 130 basis points during the three months ended September 30, 2018 compared to the corresponding period in 2017 (47.2% at September 30, 2018 compared to 45.9% at September 30, 2017) primarily as a result of sales mix.

### Selling, general and administrative expense

Selling, general and administrative expense was approximately \$3.7 million in both the three months ended September 30, 2018 and the three months ended September 30, 2017. Selling, general and administrative expense represented 16.0% of net sales for the three months ended September 30, 2018 compared to 16.4% of net sales in the corresponding period in 2017.

### Income from operations

Income from operations for the three months ended September 30, 2018 was approximately \$6.9 million compared to \$6.2 million in the same period in 2017, an increase of approximately \$0.7 million, principally as a result of the factors described above.

### Arnold

	Three months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$29,891	100.0%	\$26,489	100.0%
Gross profit	\$7,588	25.4 %	\$7,353	27.8 %
SG&A	\$4,321	14.5 %	\$4,374	16.5 %
Operating income	\$2,287	7.7 %	\$2,000	7.6 %

### Net sales

Net sales for the three months ended September 30, 2018 were approximately \$29.9 million, an increase of \$3.4 million compared to the same period in 2017. The increase in net sales is primarily a result of increased demand across various markets. International sales were \$11.7 million in the three months ended September 30, 2018 as compared to \$10.6 million in the three months ended September 30, 2017, an increase of \$1.1 million, primarily as a result of the increase in sales at PMAG.

### Gross profit

Gross profit for the three months ended September 30, 2018 was approximately \$7.6 million compared to approximately \$7.4 million in the same period of 2017. Gross profit as a percentage of net sales decreased from 27.8% for the quarter ended September 30, 2017 to 25.4% in the quarter ended September 30, 2018 principally due to product mix and increased raw material costs.

### Selling, general and administrative expense

Selling, general and administrative expense in the three month period ended September 30, 2018 was \$4.3 million, compared to approximately \$4.4 million for the three months ended September 30, 2017. Selling, general and administrative expense was 14.5% of net sales in the three months ended September 30, 2018 and 16.5% in the three months ended September 30, 2017.

### Income from operations

Income from operations for the three-months ended September 30, 2018 was approximately \$2.3 million, an increase of \$0.3 million when compared to the same period in 2017, based on the factors noted above.

### Clean Earth

	Three months ended			
	September 30, 2018		September 30, 2017	
Net revenues	\$71,117	100.0%	\$55,676	100.0%
Gross profit	\$18,611	26.2 %	\$15,889	28.5 %
SG&A	\$10,559	14.8 %	\$6,782	12.2 %
Operating income	\$4,278	6.0 %	\$5,592	10.0 %



Net revenues

Net revenues for the three months ended September 30, 2018 were approximately \$71.1 million, an increase of \$15.4 million, or 27.7%, compared to the same period in 2017. The increase in net revenues is due to improved performance across each of Clean Earth's service lines, as well as acquisitions made in the last year. For the three months ended September 30, 2018, contaminated soil revenue increased 26% as compared to the same period last year, which is principally attributable to a recent acquisition. Hazardous waste revenues increased 18% principally as a result of recent acquisitions and growth in the base business. Net revenues from dredged material increased \$3.5 million during the three months ended September 30, 2018 as compared to the same period in 2017 due to the timing of projects. Contaminated soils represented approximately 54% of net revenues for the three months ended September 30, 2018 and 55% of net revenues for the three months ended September 30, 2017.

Gross profit

Gross profit for the three months ended September 30, 2018 was approximately \$18.6 million compared to approximately \$15.9 million in the same period of 2017, with a majority of the increase in gross profit reflecting the increase in hazardous and non-hazardous soil volume during the current period, recent acquisitions and improved processing efficiencies. Gross profit as a percentage of net revenues decreased from 28.5% for the three-month period ended September 30, 2017 to 26.2% for the same period ended September 30, 2018. The decrease in gross profit as a percentage of net revenues is due to increased back-end costs for certain soil facilities.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 increased to approximately \$10.6 million, or 14.8%, of net revenues, as compared to \$6.8 million, or 12.2%, of net revenues for the same period in 2017. The increased spending is related to the transaction and integration costs of recent acquisitions and increased labor expenses.

Income from operations

Income from operations for the three months ended September 30, 2018 was approximately \$4.3 million as compared to income from operations of \$5.6 million for the three months ended September 30, 2017, a decrease of \$1.3 million, primarily as a result of those factors described above.

Foam Fabricators

	Three months ended			
	September 30, 2018		September 30, 2017	
	Pro forma			
Net sales	\$33,337	100.0%	\$32,986	100.0%
Gross profit	\$9,447	28.3 %	\$10,057	30.5 %
SG&A	\$3,101	9.3 %	\$3,190	9.7 %
Operating income	\$4,100	12.3 %	\$4,672	14.2 %

Pro forma financial information for Foam Fabricators for the three months ended September 30, 2017 includes pre-acquisition results of operations for the period from July 1, 2017 through September 30, 2017, for comparative purposes. The historical results of Foam Fabricators have been adjusted to reflect the purchase accounting adjustments recorded in connection with the acquisition: \$0.3 million in stock compensation expense and \$2.0 million in amortization expense, as well as \$0.2 million in management fees that would have been incurred by Foam Fabricators if we owned the company during this period.

Net sales

Net sales for the quarter ended September 30, 2018 were \$33.3 million, an increase of \$0.4 million, or 1.1%, compared to the quarter ended September 30, 2017. The increase in net sales was primarily due to organic growth within the existing customer base, primarily related to the appliance and protective packaging categories.

Gross profit

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Gross profit as a percentage of net sales was 28.3% and 30.5% for the three months ended September 30, 2018 and 2017, respectively. The decrease in gross profit percentage was primarily due to increased raw material costs and, to a lesser degree, increased compensation, benefits and other plant expenses. A majority of Foam Fabricator's



products are made with expanded polystyrene ("EPS") resin, an oil & natural gas derived polymer with an added expansion agent, therefore raw material costs will increase with increases in the price of oil and natural gas.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 was \$3.1 million as compared to \$3.2 million for the three months ended September 30, 2017, a decrease of \$0.1 million. Selling, general and administrative expense for the three months ended September 30, 2018 includes \$0.6 million in integration service fees paid to CGM. Excluding the integration fees, selling, general and administrative expense for the three months ended September 30, 2018 was \$0.7 million lower than the comparable period in the prior year due to lower management bonus expenses and nonrecurring expenses related to the compensation of the previous owner.

Income from operations

Income from operations was \$4.1 million for the three months ended September 30, 2018 as compared to \$4.7 million for the three months ended September 30, 2017, a decrease of \$0.6 million, primarily as a result of the factors noted above.

Sterno

	Three months ended			
	September 30, 2018		September 30, 2017	
	Pro forma			
Net sales	\$113,868	100.0%	\$95,768	100.0%
Gross profit	\$26,664	23.4 %	\$25,645	26.8 %
SG&A	\$10,577	9.3 %	\$9,637	10.1 %
Operating income	\$11,634	10.2 %	\$11,617	12.1 %

Pro forma financial information for Sterno for the three months ended September 30, 2017 includes pre-acquisition results of operations for Rimports, which was acquired by Sterno on February 28, 2018, for the period from July 1, 2017 through September 30, 2017 for comparative purposes. The historical results of Rimports have been adjusted to reflect an additional \$2.4 million in amortization expense recorded in connection with the purchase accounting adjustments related to the acquisition.

Net sales

Net sales for the three months ended September 30, 2018 were approximately \$113.9 million, an increase of \$18.1 million, or 18.9%, compared to the same period in 2017. The net sales variance reflects increased Rimports sales relating to harvest promotions, scented wax products and essential oils, as well as stronger Sterno Home candle and outdoor sales.

Gross profit

Gross profit as a percentage of net sales decreased from 26.8% for the three months ended September 30, 2017 to 23.4% for the same period ended September 30, 2018. Sterno recognized an additional \$2.0 million in expense related to the amortization of the inventory step-up resulting from the purchase price allocation of the Rimports acquisition during the third quarter of 2018. Removing the effect of the amortization of the step-up results in a gross profit percentage of 25.2%, a decrease of 160 basis points in the third quarter of 2018 as compared to the third quarter of 2017. The decrease in gross profit percentage as compared to the quarter ended September 30, 2017 primarily reflects an increase in chemical and other material costs, as well as higher freight and carrier costs.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2018 and 2017 was approximately \$10.6 million and \$9.6 million, respectively. Selling, general and administrative expense represented 9.3% of net sales for the three months ended September 30, 2018 as compared to 10.1% of net sales for the same period in 2017. Selling, general and administrative expense decreased as a percentage of net sales during the three months ended September 30, 2018 due to lower advertising and marketing costs, commissions, development expense and royalty costs at Sterno Home.



Edgar Filing: Compass Diversified Holdings - Form 10-Q

Income from operations

Income from operations for both the three months ended September 30, 2018 and 2017 was approximately \$11.6 million, based on the factors noted above.

Nine months ended September 30, 2018 compared to nine months ended September 30, 2017

Consolidated

The following table sets forth our unaudited results of operations for the nine months ended September 30, 2018 and 2017:

	Nine months ended	
	September	September
	30, 2018	30, 2017
Net revenues	\$1,239,150	\$921,330
Cost of revenues	812,653	599,552
Gross profit	426,497	321,778
Selling, general and administrative expense	295,178	239,102
Fees to manager	32,842	24,308
Amortization of intangibles	49,280	39,256
Impairment expense	—	8,864
Operating income	49,197	10,248
Interest expense	(35,465)	(22,499)
Amortization of debt issuance costs	(2,978)	(2,940)
Other income (expense)	(3,094)	(2,670)
Income (loss) from continuing operations before income taxes	7,660	(17,861)
Provision (benefit) for income taxes	4,147	(2,002)
Income (loss) from continuing operations	\$3,513	\$(15,859)

Net revenues

On a consolidated basis, net revenues for the nine months ended September 30, 2018 increased by approximately \$317.8 million, or 34.5%, compared to the corresponding period in 2017. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$82.0 million and \$92.3 million, respectively, to the increase in net revenues, while our acquisition of Velocity Outdoor in June 2017 contributed \$50.2 million to the increase in net revenues. During the nine months ended September 30, 2018 compared to 2017, we also saw notable revenue increases at Clean Earth (\$46.2 million increase), 5.11 (\$23.6 million increase), Arnold (\$11.1 million increase), our legacy Sterno business exclusive of Rimports (\$11.6 million increase) and Manitoba Harvest (\$10.5 million increase), partially offset by a decrease in sales at our Liberty and Ergobaby businesses (\$4.3 million and \$7.4 million decrease, respectively). Refer to "Results of Operations - Business Segments" for a more detailed analysis of net revenues by business segment.

We do not generate any revenues apart from those generated by the businesses we own. We may generate interest income on the investment of available funds, but we expect such earnings to be minimal. Our investment in our businesses is typically in the form of loans from the Company to such businesses, as well as equity interests in those companies. Cash flows coming to the Trust and the Company are the result of interest payments on those loans, amortization of those loans and dividends on our equity ownership. However, on a consolidated basis, these items will be eliminated.

Cost of revenues

On a consolidated basis, cost of revenues increased approximately \$213.1 million during the nine month period ended September 30, 2018 compared to the corresponding period in 2017. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$60.0 million and \$72.3 million, respectively, to the increase, while our acquisition of Velocity Outdoor in June 2017 contributed \$35.4 million to the increase in cost of goods sold. Clean Earth's cost of revenue increased \$32.4 million, in line with the increase in revenues during the first three quarters of

2018. These i

51

---

increases were offset by decreases in cost of revenues at other operating segments, particularly 5.11 (\$8.8 million decrease as compared to the cost of revenues during the corresponding period in 2017 that included \$21.7 million in expense associated with the basis step up of inventory from the purchase price allocation). Gross profit as a percentage of net revenues was approximately 34.4% in the nine months ended September 30, 2018 compared to 34.9% in the nine months ended September 30, 2017. Refer to "Results of Operations - Business Segments" for a more detailed analysis of cost of revenues by business segment.

#### Selling, general and administrative expense

Consolidated selling, general and administrative expense increased approximately \$56.1 million during the nine month period ended September 30, 2018, compared to the corresponding period in 2017. The increase in selling, general and administrative expense in the first three quarters of 2018 compared to the first three quarters of 2017 is principally the result of the acquisition of Foam Fabricators (\$8.8 million, including \$1.6 million in acquisition costs), Rimports (\$6.2 million, including \$0.6 million in acquisition costs) and Velocity Outdoor (\$8.7 million), as well as notable increases at 5.11 Tactical (\$14.7 million increase) Clean Earth (\$8.2 million increase) and Manitoba Harvest (\$5.0 million increase). Refer to "Results of Operations - Business Segments" for a more detailed analysis of selling, general and administrative expense by business segment. At the corporate level, general and administrative expense was \$10.3 million in the nine months ended September 30, 2018 compared to \$9.0 million in the nine months ended September 30, 2017. Included in corporate was \$0.6 million of professional fees associated with the refinancing of our credit facility that were expensed in the second quarter of 2018. The remaining amount of the increase at corporate was due to professional fees incurred in 2018 to implement the new revenue recognition standard at our businesses.

#### Fees to manager

Pursuant to the Management Services Agreement ("MSA"), we pay CGM a quarterly management fee equal to 0.5% (2.0% annually) of our consolidated adjusted net assets. We accrue for the management fee on a quarterly basis. For the nine months ended September 30, 2018, we incurred approximately \$32.8 million in management fees as compared to \$24.3 million in fees in the nine months ended September 30, 2017. The increase was the result of our Foam Fabricators and Rimports acquisitions in February 2018.

#### Amortization expense

Amortization expense for the nine months ended September 30, 2018 increased \$10.0 million as compared to the nine months ended September 30, 2017 primarily as a result of the acquisition of Foam Fabricators and Rimports in February 2018, Velocity Outdoor in June 2017 and add-on acquisitions in the current and prior year.

#### Interest Expense

We recorded interest expense totaling \$35.5 million for the nine months ended September 30, 2018 compared to \$22.5 million for the comparable period in 2017, an increase of \$13.0 million. The increase in interest expense primarily reflects the interest associated with the issuance of our Senior Notes in April 2018 and the increase in the amount outstanding on our revolving credit facility in the current year. The first payment of interest on the Senior Notes will be in November 2018, and for the period from the date of issuance through September 30, 2018, we recorded \$14.5 million in interest expense. The average amount outstanding on our revolving credit facility in the first three quarters of 2017 was \$29.1 million, while the average amount outstanding during the first nine months of 2018 was \$187.0 million as a result of our add-on acquisition that occurred in 2018. Our interest expense also reflects the effect of the unrealized gains or losses on our interest rate swap. In 2018, we recognized an unrealized gain of \$4.6 million, which reduced our interest expense, while in 2017, we recognized an unrealized loss of \$1.2 million, which was additional interest expense in 2017.

## Income Taxes

We had income tax expense of \$4.1 million with an effective income tax rate of 54.1% during the nine months ended September 30, 2018 compared to income tax benefit of \$2.0 million with an effective income tax rate of (11.2%) during the same period in 2017. The effective tax rate for the nine months ended September 30, 2018 and 2017 includes a loss at our parent company, which is taxed as a partnership. In December 2017, the U.S. government enacted the Tax Cuts and Jobs Act (the "Tax Act") which made broad and complex changes to the U.S. tax code. Among other changes of the Tax Act, the tax rate on corporations was reduced from from 35% to 21%; a limitation on the deduction of interest expense was enacted, certain tangible property acquired after September 2017 will qualify for 100% expensing, U.S federal income tax on foreign earnings was eliminated (subject to certain exceptions) and a new base erosion anti-tax abuse tax were added. Although the Company is treated as a partnership for U.S. federal income tax purposes, each of our businesses was affected by the Tax Act, and the resulting impact significantly affected the calculation of our year-to-date consolidated income tax provision in 2018. Additionally, in the current year, the effect of the recapitalization at Sterno and state income taxes as well as the geographic mix of income had a significant impact on our effective tax rate. In the prior year, the impairment expense at our Arnold business and non-deductible costs at the corporate level, including the effect of the loss on our equity investment of Fox Factory Holding Corp. ("FOX") prior to the sale of our remaining FOX shares in the first quarter of 2017, account for the majority of the remaining difference in our effective income tax rates in the first nine months of 2017.

## Branded Consumer Businesses

### 5.11 Tactical

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$252,022	100.0 %	\$228,471	100.0 %
Gross profit	\$119,194	47.3 %	\$86,881	38.0 %
SG&A	\$108,742	43.1 %	\$94,000	41.1 %
Operating income (loss)	\$3,143	1.2 %	\$(14,542)	(6.4 %) %

#### Net sales

Net sales for the nine months ended September 30, 2018 were \$252.0 million as compared to net sales of \$228.5 million for the nine months ended September 30, 2017, an increase of \$23.6 million, or 10.3%. This increase is due primarily to retail and e-commerce sales growth of \$18.1 million or 54.7%, driven by growing demand in direct to consumer channels. Retail sales grew largely due to twenty-eight new retail store openings since September 2017 (bringing the total store count to forty-two as of September 30, 2018). The increase in net sales for the nine months ended September 30, 2018 as compared to the corresponding period in the prior year was offset by a \$13.7 million decline in Direct-to-Agency sales.

#### Gross profit

Gross profit as a percentage of net sales was 47.3% in the nine months ended September 30, 2018 as compared to 38.0% in the nine months ended September 30, 2017. Cost of sales for the nine months ended September 30, 2017 includes \$21.7 million in expense related to a \$39.1 million inventory step-up resulting from the acquisition purchase price allocation. The total inventory step-up amount of \$39.1 million was expensed to cost of goods sold over the expected turns of 5.11's inventory. Excluding the effect of the inventory step-up, the gross profit for the nine months ended September 30, 2017 was 47.5%. The decrease in gross profit percentage in the nine months ended September 30, 2018 was primarily due to a higher level of chargebacks incurred and discretionary discounts granted to customers while working through the backlog associated with challenges experienced while implementing a new Enterprise Resource Planning (ERP) system.

**Selling, general and administrative expense**

Selling, general and administrative expense for the nine months ended September 30, 2018 was \$108.7 million, or 43.1% of net sales compared to \$94.0 million, or 41.1% of net sales for the comparable period in 2017. This increase in selling, general and administrative expense as a percentage of net sales was primarily due to twenty-eight new retail stores that were not open in the prior comparable period, higher temporary labor costs associated with the ERP implementation, higher software maintenance costs related to the ERP system and costs to move into 5.11's new Manteca warehouse facility, which occurred in the second quarter of 2018.

**Income (loss) from operations**

Income from operations for the nine months ended September 30, 2018 was \$3.1 million, an increase of \$17.7 million when compared to loss from operations of \$14.5 million for the same period in 2017, based on the factors described above.

**Ergobaby**

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$70,376	100.0%	\$77,737	100.0%
Gross profit	\$46,751	66.4 %	\$52,246	67.2 %
SG&A	\$30,644	43.5 %	\$28,359	36.5 %
Operating income	\$10,106	14.4 %	\$14,728	18.9 %

**Net sales**

Net sales for the nine months ended September 30, 2018 were \$70.4 million, a decrease of \$7.4 million, or 9.5%, compared to the same period in 2017. Net sales from Baby Tula for the first nine months of 2018 were \$15.8 million, compared to \$16.5 million for the corresponding period in 2017. During the nine months ended September 30, 2018, international sales were approximately \$44.6 million, representing a decrease of \$1.7 million over the corresponding period in 2017. Domestic sales were \$25.8 million in the first nine months of 2018, reflecting a decrease of \$5.7 million compared to the corresponding period in 2017. The decrease in domestic sales was primarily the result of the disruption in the retail landscape during 2018, including the continuing effect of the bankruptcy of a large national retail customer.

**Gross profit**

Gross profit was \$46.8 million for the nine months ended September 30, 2018, or 66.4% of net sales, as compared to \$52.2 million, or 67.2% of net sales for the nine months ended September 30, 2017. The decrease in gross profit as a percentage of net sales in the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 was due to changes in product mix and increased production costs as a result of the launch of a new stroller product.

**Selling, general and administrative expense**

Selling, general and administrative expense was \$30.6 million, or 43.5% of net sales for the nine months ended September 30, 2018 as compared to \$28.4 million or 36.5% of net sales for the same period of 2017. The increase in selling, general and administrative expense in the nine months ended September 30, 2018 as compared to the comparable period in the prior year is due to increases in employee related costs, additional marketing for the new stroller product category launch, additional expense related to the closure of a large retail account, higher distribution and fulfillment costs, commissions due to the mix of sales, as well as the impact of foreign exchange rates.

**Income from operations**

Income from operations for the nine months ended September 30, 2018 decreased \$4.6 million, to \$10.1 million, compared to \$14.7 million for the same period of 2017. This decrease was principally based on the factors described above.

**Liberty Safe**

Nine months ended

Edgar Filing: Compass Diversified Holdings - Form 10-Q

	September 30, 2018		September 30, 2017	
Net sales	\$61,741	100.0%	\$66,008	100.0%
Gross profit	\$15,330	24.8 %	\$18,851	28.6 %
SG&A	\$10,008	16.2 %	\$11,284	17.1 %
Operating income	\$4,894	7.9 %	\$6,900	10.5 %

Net sales

Net sales for the nine months ended September 30, 2018 decreased approximately \$4.3 million, or 6.5%, to \$61.7 million, compared to the nine months ended September 30, 2017. Non-Dealer sales were approximately \$24.2 million in the nine months ended September 30, 2018 compared to \$29.9 million for the nine months ended September 30, 2017, representing a decrease of \$5.7 million, or 19.0%. Dealer sales totaled approximately \$37.5 million in the nine months ended September 30, 2018 compared to \$36.1 million in the same period in 2017, representing an increase of \$1.4 million or 3.9%. Liberty continues to face negative trends in the U.S. outdoor retail market, including the



bankruptcy filing by a national retailer in the prior year, slower ordering and reductions of inventory levels as a result of the merger of two major outdoor retailers and softer sales at retailers dealing in sporting goods.

Gross profit

Gross profit as a percentage of net sales totaled approximately 24.8% and 28.6% for the nine months ended September 30, 2018 and September 30, 2017, respectively. The decrease in gross profit as a percentage of net sales during the nine months ended September 30, 2018 compared to the same period in 2017 is primarily attributable to cost increases in raw materials. Liberty has continued to see a rise in raw material costs, particularly the cost of steel, during 2018 as the tariffs on imported steel has led to rising domestic steel prices. On average, materials account for approximately 60% of the total costs of a safe, with steel accounting for 40% of material costs.

Selling, general and administrative expense

Selling, general and administrative expense was \$10.0 million for the nine months ended September 30, 2018 compared to \$11.3 million for the nine months ended September 30, 2017. Selling, general and administrative expense represented 16.2% of net sales in the first three quarters of 2018 and 17.1% of net sales for the same period of 2017. The decrease in selling, general and administrative expense as a percentage of net sales is primarily a result of a reserve recorded in the first quarter of 2017 related to a national retailer bankruptcy.

Income from operations

Income from operations decreased \$2.0 million during the nine months ended September 30, 2018 to \$4.9 million, compared to the corresponding period in 2017. This decrease was principally based on the factors described above.

Manitoba Harvest

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$53,169	100.0 %	\$42,625	100.0 %
Gross profit	\$23,546	44.3 %	\$19,213	45.1 %
SG&A	\$20,527	38.6 %	\$15,502	36.4 %
Operating income (loss)	\$(670 )	(1.3 )%	\$75	0.2 %

Net sales

Net sales for the nine months ended September 30, 2018 were approximately \$53.2 million as compared to \$42.6 million for the nine months ended September 30, 2017, an increase of \$10.5 million, or 24.7%. During the first nine months of 2018, Manitoba Harvest experienced strong growth across both the branded and ingredient segments. Consumer awareness programs, new distribution gains, and consumer demand for plant-based protein continue to drive sales of their shelled hemp seed and hemp oil products.

Gross profit

Gross profit for the nine months ended September 30, 2018 was approximately \$23.5 million compared to approximately \$19.2 million for the same period in 2017, an increase of \$4.3 million. Gross profit as a percentage of net sales was 44.3% in the nine months ended September 30, 2018 and 45.1% in the nine months ended September 30, 2017. The decrease in gross profit as a percentage of net sales in the first nine months of 2018 as compared to the same period in the prior year is primarily attributable to higher logistics costs.

Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2018 was approximately \$20.5 million as compared to \$15.5 million in the nine months ended September 30, 2017. Selling, general and administrative expense was 38.6% of net sales in the first nine months of 2018 as compared to 36.4% of net sales for the same period in 2017. The increase in selling, general and administrative expense in the nine months ended September 30, 2018 compared to the same period in 2017 was primarily due to ongoing investments in key operating capability initiatives such as creative production, digital media, public relations, creative production, field sales and research and development.

## Income (loss) from operations

Manitoba Harvest had a loss from operations for the nine months ended September 30, 2018 of \$0.7 million, as compared to income from operations of \$0.1 million for the nine months ended September 30, 2017. While gross profit for the nine months ended September 30, 2018 increased \$4.3 million, the ongoing investment in their business that Manitoba Harvest has made has led to an offsetting increase in selling, general and administrative expense in the current year.

## Velocity Outdoor

	Nine months ended			
	September 30, 2018		September 30, 2017 <sup>(1)</sup>	
	Pro forma			
Net sales	\$94,266	100.0%	\$85,848	100.0%
Gross profit	\$26,474	28.1 %	\$18,760	21.9 %
SG&A	\$17,335	18.4 %	\$13,715	16.0 %
Operating income	\$5,125	5.4 %	\$1,172	1.4 %

Pro forma financial information for Velocity Outdoor for the nine months ended September 30, 2017 includes pre-acquisition results of operations for the period from January 1, 2017 through June 2, 2017, the date of the Velocity Outdoor acquisition, for comparative purposes. The historical results of Velocity Outdoor were adjusted in the prior year to reflect the purchase accounting adjustments recorded in connection with the acquisition.

## Net sales

Net sales for the nine months ended September 30, 2018 were \$94.3 million, an increase of \$8.4 million or 9.8%, compared to the same period in 2017. The increase in net sales for the nine months ended September 30, 2018 is primarily due to Junior Reserve Officers Training Corps sales along with add on acquisitions in the third quarters of 2017 and 2018.

## Gross profit

Gross profit as a percentage of net sales was 28.1% for the nine months ended September 30, 2018 as compared to 21.9% in the nine months ended September 30, 2017. The cost of goods sold for the nine months ended September 30, 2017 included expense of \$3.2 million reflecting the impact of the inventory step-up expense resulting from our acquisition of Velocity in June 2017.

## Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2018 was \$17.3 million, or 18.4% of net sales compared to \$13.7 million, or 16.0% of net sales for the nine months ended September 30, 2017. The selling, general and administrative expense for the nine months ended September 30, 2018 includes \$0.4 million of incremental integration services fees payable to CGM, and \$1.3 million in acquisition costs related to our acquisition of Ravin in September 2018. The balance of the expense growth is related to increased sales support, marketing spend, and the impacts of the 2017 and 2018 acquisitions.

## Income from operations

Income from operations for the nine months ended September 30, 2018 was \$5.1 million, an increase of \$4.0 million when compared to income from operations of \$1.2 million for the same period in 2017, based on the factors described above.

## Niche Industrial Businesses

## Advanced Circuits

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$68,454	100.0%	\$66,404	100.0%
Gross profit	\$31,582	46.1 %	\$30,309	45.6 %
SG&A	\$11,085	16.2 %	\$10,895	16.4 %
Operating income	\$19,202	28.1 %	\$18,106	27.3 %

Net sales

Net sales for the nine months ended September 30, 2018 increased approximately \$2.1 million to \$68.5 million compared to the nine months ended September 30, 2017. The increase in net sales was due to increased sales in Quick-Turn Production PCBs by approximately \$0.9 million, Long-Lead Time PCBs by approximately \$1.2 million, Subcontract by approximately \$0.8 million, and decreased Promotion by approximately \$0.6 million. This was partially offset by decreases in Assembly sales by approximately \$0.7 million and Quick-Turn Small-Run PCBs by approximately \$0.7 million. On a consolidated basis at ACI, Quick-Turn Small-Run PCBs comprised approximately 19.3% of gross sales and Quick-Turn Production PCBs represented approximately 33.5% of gross sales for the nine months ended September 30, 2018. Quick-Turn Small-Run PCBs comprised approximately 20.7% of gross sales and Quick-Turn Production PCBs represented approximately 32.9% of gross sales for the nine months ended September 30, 2017.

Gross profit

Gross profit as a percentage of net sales increased 50 basis points during the nine months ended September 30, 2018 compared to the corresponding period in 2017 (46.1% at September 30, 2018 compared to 45.6% at September 30, 2017) primarily as a result of sales mix.

Selling, general and administrative expense

Selling, general and administrative expense was approximately \$11.1 million in the nine months ended September 30, 2018 and \$10.9 million in the nine months ended September 30, 2017. Selling, general and administrative expense represented 16.2% of net sales for the nine months ended September 30, 2018 compared to 16.4% of net sales in the corresponding period in 2017.

Income from operations

Income from operations for the nine months ended September 30, 2018 was approximately \$19.2 million compared to \$18.1 million in the same period in 2017, an increase of approximately \$1.1 million, principally as a result of the factors described above.

Arnold

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net sales	\$90,486	100.0%	\$79,421	100.0 %
Gross profit	\$24,083	26.6 %	\$20,574	25.9 %
SG&A	\$14,177	15.7 %	\$13,285	16.7 %
Operating income (loss)	\$6,957	7.7 %	\$(4,551)	(5.7)%

Net sales

Net sales for the nine months ended September 30, 2018 were approximately \$90.5 million, an increase of \$11.1 million compared to the same period in 2017. The increase in net sales is primarily a result of increased demand across various markets, particularly aerospace and defense. International sales were \$36.1 million in the nine months ended September 30, 2018 as compared to \$31.7 million in the nine months ended September 30, 2017, an increase of \$4.4 million, primarily as a result of an increase in sales at PMAG.

Gross profit

Gross profit for the nine months ended September 30, 2018 was approximately \$24.1 million compared to approximately \$20.6 million in the same period of 2017. Gross profit as a percentage of net sales increased from 25.9% for the nine months ended September 30, 2017 to 26.6% in the nine months ended September 30, 2018 principally due to increased sales volume and manufacturing efficiencies.

Selling, general and administrative expense

Selling, general and administrative expense in the nine-month period ended September 30, 2018 was \$14.2 million, compared to approximately \$13.3 million for the nine months ended September 30, 2017. Selling, general and administrative expense represented 15.7% of net sales for the nine months ended September 30, 2018 compared to 16.7% of net sales in the corresponding period in 2017.

Income (loss) from operations

Income from operations for the nine months ended September 30, 2018 was approximately \$7.0 million, an increase of \$11.5 million when compared to the same period in 2017. In the first quarter of 2017, Arnold recorded goodwill impairment expense of \$8.9 million related to an interim goodwill impairment test at December 31, 2016. The remaining amount of the increase in income from operations was based on the factors described above.

Clean Earth

	Nine months ended			
	September 30, 2018		September 30, 2017	
Net revenues	\$199,579	100.0 %	\$153,370	100.0 %
Gross profit	\$56,590	28.4 %	\$42,731	27.9 %
SG&A	\$33,399	16.7 %	\$25,205	16.4 %
Operating income	\$12,495	6.3 %	\$7,597	5.0 %

Net revenues

Net revenues for the nine months ended September 30, 2018 were approximately \$199.6 million, an increase of \$46.2 million, or 30.1%, compared to the same period in 2017. For the nine months ended September 30, 2018, contaminated soil revenue increased 22% as compared to the same period last year, which is principally attributable to recent large project awards and the impact of a recent acquisition. Hazardous waste revenues increased 24% principally as a result of a large customer project and recent acquisitions. Net revenues from dredged material increased \$12.9 million for the nine months ended September 30, 2018 as compared to the same period in 2017 due to the timing of projects. Contaminated soils represented approximately 53% of net revenues for the nine months ended September 30, 2018 and 57% of net revenues for the nine months ended September 30, 2017.

Gross profit

Gross profit for the nine months ended September 30, 2018 was approximately \$56.6 million compared to approximately \$42.7 million in the same period of 2017, with increases in the gross profit at each of Clean Earth's service lines during the current period and improved processing efficiencies. Gross profit as a percentage of net revenues increased from 27.9% for the nine-month period ended September 30, 2017 to 28.4% for the nine months ended September 30, 2018.

Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2018 increased to approximately \$33.4 million, or 16.7%, of net revenues, as compared to \$25.2 million, or 16.4%, of net revenues for the nine months ended September 30, 2017. The increase was consistent with the increase in net revenues.

Income from operations

Income from operations for the nine months ended September 30, 2018 was approximately \$12.5 million as compared to \$7.6 million for the nine months ended September 30, 2017, an increase of \$4.9 million, primarily as a result of those factors described above.

## Foam Fabricators

	Nine months ended			
	September 30, 2018		September 30, 2017	
	Pro forma		Pro forma	
Net sales	\$97,021	100.0%	\$95,100	100.0%
Gross profit	\$25,985	26.8 %	\$29,661	31.2 %
SG&A	\$10,560	10.9 %	\$9,524	10.0 %
Operating income	\$9,054	9.3 %	\$13,550	14.2 %

Pro forma financial information for Foam Fabricators for the nine months ended September 30, 2018 and 2017 includes pre-acquisition results of operations for the period from January 1, 2017 through September 30, 2017, and January 1, 2018 through February 15, 2018, the acquisition date of Foam Fabricators, for comparative purposes. The historical results of Foam Fabricators for the nine months ended September 30, 2017 and the period from January 1, 2018 through February 15, 2018 have been adjusted to reflect the purchase accounting

adjustments recorded in connection with the acquisition. In the nine months ended September 30, 2017, we recorded \$0.8 million in stock compensation expense, \$0.3 million reduction in depreciation expense and \$6.0 million in amortization expense, as well as \$0.6 million in management fees that would have been incurred by Foam Fabricators if we owned the company during this period. The historical results of Foam Fabricators for the period from January 1, 2018 through February 15, 2018 have been adjusted to reflect \$0.2 million in stock compensation expense, \$0.1 million in depreciation expense, and \$1.0 million in amortization expense, as well as \$0.1 million in management fees that would have been incurred by Foam Fabricators if we owned the company during this period.

Net sales

Net sales for the nine months ended September 30, 2018 were \$97.0 million, an increase of \$1.9 million, or 2.0%, compared to the nine months ended September 30, 2017. The increase in net sales was due to organic growth with the existing customer base, primarily related to the appliance and other packaging categories.

Gross profit

Gross profit as a percentage of net sales was 26.8% and 31.2%, respectively, for the nine months ended September 30, 2018 and 2017. The cost of sales for the nine months ended September 30, 2018 includes \$0.7 million related to the inventory step-up resulting from the acquisition purchase price allocation. Excluding the effect of the inventory step-up, the gross profit as a percentage of net sales for the nine months ended September 30, 2018 was 27.5%, a decrease of 370 basis points compared to the comparable period in the prior year. The decrease in gross profit percentage was primarily due to increased raw material costs and, to a lesser degree, increased compensation, benefits and other plant expenses.

Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2018 was \$10.6 million as compared to \$9.5 million for the nine months ended September 30, 2017, an increase of \$1.0 million. Selling, general and administrative expense for the nine months ended September 30, 2018 includes \$1.4 million in integration service fees paid to CGM and \$1.5 million in transaction costs paid in relation to the acquisition of Foam Fabricators. Excluding the integration fees and transaction costs, selling, general and administrative expense for the nine months ended September 30, 2018 was \$1.9 million lower than the comparable period in the prior year due to lower management bonus expenses and nonrecurring expenses related to the compensation of the previous owner.

Income from operations

Income from operations was \$9.1 million for the nine months ended September 30, 2018 as compared to \$13.6 million for the nine months ended September 30, 2017, a decrease of \$4.5 million based on the factors noted above.

Sterno

	Nine months ended			
	September 30, 2018		September 30, 2017	
	Pro forma		Pro forma	
Net sales	\$291,864	100.0 %	\$264,734	100.0 %
Gross profit	\$67,381	23.1 %	\$71,580	27.0 %
SG&A	\$31,161	10.7 %	\$30,205	11.4 %
Operating income	\$22,860	7.8 %	\$28,203	10.7 %

Pro forma financial information for Sterno for the nine months ended September 30, 2018 and 2017 includes pre-acquisition results of operations for Rimports, which was acquired by Sterno on February 28, 2018. The historical results of Sterno have been adjusted to include the results of Rimports for all periods presented. The historical results of Rimports reflect the purchase accounting adjustments recorded in connection with the acquisition. For the two months ended February 28, 2018, the historical results of Rimports include an additional \$1.6 million in amortization expense recorded in connection with the purchase accounting adjustments related to the acquisition, and for the nine months ended September 30, 2017, the historical results of Rimports include an additional \$4.9 million in amortization expense recorded in connection with the purchase accounting adjustments related to the acquisition.

Net sales

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Net sales for the nine months ended September 30, 2018 were approximately \$291.9 million, an increase of \$27.1 million, or 10.2%, compared to the same period in 2017. The net sales variance reflects increased Rimports sales relating to harvest promotions, scented wax products and essential oils, as well as stronger Sterno Home candle and outdoor sales.

59

---

Gross profit

Gross profit as a percentage of net sales decreased from 27.0% for the nine months ended September 30, 2017 to 23.1% for the same period ended September 30, 2018. Sterno recognized \$4.6 million in cost of goods sold in the second quarter of 2018 and \$2.0 million in the third quarter of 2018 related to the amortization of the inventory step-up resulting from the purchase price allocation of the Rimports acquisition. After eliminating the effect of the inventory step-up, gross profit as a percentage of net sales was 25.4% for the nine months ended September 30, 2018. The decrease in gross profit percentage during the nine months ended September 30, 2018 primarily reflects an increase in chemical and other material costs, as well as higher freight and carrier costs.

Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2018 was approximately \$31.2 million, as compared to \$30.2 million for the nine months ended September 30, 2017 an increase of \$1.0 million. Selling, general and administrative expense represented 10.7% of net sales for the nine months ended September 30, 2018 as compared to 11.4% of net sales for the nine months ended September 30, 2017. Selling, general and administrative expense decreased as a percentage of net sales during the nine months ended September 30, 2018 due to an increase in sales during the current period, and lower marketing costs, commissions, development expense and reduced legal fees at Sterno Home.

Income from operations

Income from operations for the nine months ended September 30, 2018 was approximately \$22.9 million, a decrease of \$5.3 million when compared to the same period in 2017, primarily as a result of the effect of the inventory step-up expense associated with the Rimports acquisition, as described above.

Liquidity and Capital Resources

Liquidity

At September 30, 2018, we had approximately \$36.2 million of cash and cash equivalents on hand, a decrease of \$3.7 million as compared to the year ended December 31, 2017. The majority of our cash is in non-interest bearing checking accounts or invested in short-term money market accounts and is maintained in accordance with the Company's investment policy, which identifies allowable investments and specifies credit quality standards.

The change in cash and cash equivalents is as follows:

Operating Activities:

(in thousands)	Nine months ended September 30,	
	2018	2017
Cash provided by operating activities	\$58,772	\$ 59,236

For the nine months ended September 30, 2018, cash flows provided by operating activities totaled approximately \$58.8 million, which represents a \$0.5 million decrease compared to cash provided by operating activities of \$59.2 million during the nine-month period ended September 30, 2017. Cash used in operating activities for working capital for the nine months ended September 30, 2018 was \$33.0 million, as compared to cash used in operating activities for working capital of \$24.3 million for the nine months ended September 30, 2017. The increase in cash used for working capital purposes in the current year primarily reflects the effect of our acquisitions that occurred in February 2018 which resulted in a significant increase in operational cash flows, particularly at Rimports, our Sterno add-on acquisition, which has higher second and third quarter cash usage that is not reflected in the prior period.

Investing Activities:

(in thousands)	Nine months ended September 30,	
	2018	2017
Cash used in investing activities	\$(594,705)	\$ (62,956 )

Cash flows used in investing activities for the nine months ended September 30, 2018 totaled approximately \$594.7 million, compared to cash used in investing activities of \$63.0 million in the same period of 2017. In the current year,





we had a platform acquisition in the first quarter, Foam Fabricators, and several add on acquisitions at our subsidiaries. Sterno acquired Rimports in February 2018, Clean Earth has had several add-on acquisitions throughout this year, and our Velocity Outdoor subsidiary acquired Ravin in September 2018. The total amount spent on acquisitions in the nine months ended September 30, 2018 was approximately \$551.9 million, while in the nine months ended September 30, 2017, we spent approximately \$164.7 million on acquisitions, including our platform acquisition of Velocity Outdoor in June 2017. In the prior year, we received approximately \$136.1 million related to the sale of our remaining investment in FOX, which offset the cash used for investing activities. Capital expenditures in the nine months ended September 30, 2018 increased approximately \$10.2 million compared to the same period in the prior year, due primarily to expenditures at our 5.11 and Arnold businesses, as well as the effect of a full year of Velocity Outdoor ownership, and our Foam Fabricators acquisition. We expect capital expenditures for the full year of 2018 to be approximately \$45 million to \$55 million.

#### Financing Activities:

(in thousands)	Nine months ended	
	September 30, 2018	September 30, 2017
Cash provided by financing activities	\$ 531,288	\$ 7,862

Cash flows provided by financing activities totaled approximately \$531.3 million during the nine months ended September 30, 2018 compared to cash flows provided by financing activities of \$7.9 million during the nine months ended September 30, 2017. The 2018 activity primarily related to the financing of our acquisitions of Foam Fabricators and Rimports in February 2018, which were financed through draws on our 2014 Revolving Credit Facility, partially offset by net proceeds of \$96.5 million from the Series B Preferred Shares offering in March 2018 which was used to repay a portion of the outstanding amount on the 2014 Revolving Credit Facility. In April 2018, we issued \$400 million in Senior Notes and amended our credit facility. The proceeds from the issuance of the Senior Notes were used to pay down outstanding amounts under our credit facility. Concurrently with the issuance of our Senior Notes, we refinanced our 2014 Credit Facility and reduced the amount outstanding on our term loan from \$558.6 million to \$500 million. In addition to activity on our credit facility, financing activities reflect the payment of our quarterly common share distributions (\$64.7 million in 2018 and 2017) and preferred share distributions (\$8.4 million in 2018), and the payment of a profit allocation (\$39.2 million in 2017) related to the sale of our FOX shares.

#### Intercompany Debt

A component of our acquisition financing strategy that we utilize in acquiring the businesses we own and manage is to provide both equity capital and debt capital, raised at the parent level through our existing credit facility. Our strategy of providing intercompany debt financing within the capital structure of the businesses that we acquire and manage allows us the ability to distribute cash to the parent company through monthly interest payments and amortization of the principal on these intercompany loans. Each loan to our businesses has a scheduled maturity and each business is entitled to repay all or a portion of the principal amount of the outstanding loans, without penalty, prior to maturity. Certain of our businesses have paid down their respective intercompany debt balances through the cash flow generated by these businesses and we have recapitalized, and expect to continue to recapitalize, these businesses in the normal course of our business. The recapitalization process involves funding the intercompany debt using either cash on hand at the parent or our applicable Credit Facility, and serves the purpose of optimizing the capital structure at our subsidiaries and providing the noncontrolling shareholders with a distribution on their ownership interest in a cash flow positive business. In January 2018, the Company completed a recapitalization at Sterno whereby the Company entered into an amendment to the intercompany loan agreement with Sterno (the "Sterno Loan Agreement"). The Sterno Loan Agreement was amended to (i) provide for term loan borrowings of \$57.7 million to fund a distribution to the Company, which owned 100% of the outstanding equity of Sterno at the time of the recapitalization, and (ii) extend the maturity dates of the term loans.

In the first quarter of 2018, we amended the credit facility with Arnold whereby the maturity date of the Term A loan was extended to February 2024, and the maturity date of the Term B loan was extended to February 2025, and the financial covenants in the Arnold credit facility were updated to reflect changes in the company subsequent to

acquisition in March 2012. Additionally, due to significant capital expenditures related to the implementation of a new ERP system, warehouse expansion and retail roll out, we have granted 5.11 waivers under their intercompany debt agreement effective as of the quarter ended September 30, 2017 through December 31, 2018. The waivers permit 5.11 to increase its allowable capital expenditure limits and exclude certain capital expenditures associated with the ERP system and warehouse expansion from the calculation of the fixed charge coverage ratio. Manitoba Harvest was not in compliance with the financial covenants under their intercompany loan agreement at December 31, 2017, and we amended the

Manitoba Harvest intercompany debt agreement to grant a waiver to them through December 31, 2018. Subsequent to the third quarter of 2018, we amended the Sterno Loan Agreement to increase the amount available to Sterno under their intercompany revolving credit facility. Except as previously noted, all of our subsidiaries were in compliance with the financial covenants included within their intercompany credit arrangements at September 30, 2018.

As of September 30, 2018, we had the following outstanding loans due from each of our businesses:

(in thousands)

5.11 Tactical	\$203,765
Ergobaby	\$56,760
Liberty	\$47,504
Manitoba Harvest	\$49,355
Advanced Circuits	\$82,727
Arnold	\$72,580
Clean Earth	\$217,985
Foam Fabricators	\$105,958
Sterno	\$281,506
Velocity Outdoor	\$130,763

Our primary source of cash is from the receipt of interest and principal on the outstanding loans to our businesses. Accordingly, we are dependent upon the earnings of and cash flow from these businesses, which are available for (i) operating expenses; (ii) payment of principal and interest under our 2018 Credit Facility; (iii) payments to CGM due pursuant to the MSA and the LLC Agreement; (iv) cash distributions to our shareholders; and (v) investments in future acquisitions. Payments made under (iii) above are required to be paid before distributions to shareholders and may be significant and exceed the funds held by us, which may require us to dispose of assets or incur debt to fund such expenditures.

We believe that we currently have sufficient liquidity and capital resources to meet our existing obligations, including quarterly distributions to our shareholders, as approved by our board of directors, over the next twelve months.

#### Financing Arrangements

##### 2018 Credit Facility

In April 2018, we entered into an Amended and Restated Credit Agreement to amend and restate the 2014 Credit Facility, originally dated as of June 6, 2014 (as previously amended, the “Existing Credit Agreement” and as further amended by the Amended and Restated Credit Agreement, the “2018 Credit Facility”). The 2018 Credit Facility provides for (i) revolving loans, swing line loans and letters of credit (the “2018 Revolving Line of Credit”) up to a maximum aggregate amount of \$600 million (the “2018 Revolving Loan Commitment”), and (ii) a \$500 million term loan (the “2018 Term Loan”).

Under the 2018 Term Loan, advances under term loans can be either Eurodollar rate loans or base rate loans. Eurodollar rate term loans bear interest on the outstanding principal amount thereof for each interest period at a rate per annum based on the Eurodollar Rate for such interest period plus a margin of either 2.25% or 2.50%, based on the Consolidated Total Leverage Ratio. Base rate term loans bear interest on the outstanding principal amount thereof from the applicable borrowing date at a rate per annum equal to the Base Rate plus either 1.25% or 1.50%, based on the Consolidated Total Leverage Ratio. The initial 2018 Term Loan was advanced as a Eurodollar rate loan. Advances under the 2018 Revolving Line of Credit can be either Eurodollar rate loans or base rate loans. Eurodollar rate revolving loans bear interest on the outstanding principal amount thereof for each interest period at a rate per annum based on the London Interbank Offered Rate approved by the Agent (the “Eurodollar Rate”) for such interest period plus a margin ranging from 1.50% to 2.50%, based on the ratio of consolidated net indebtedness to adjusted consolidated earnings before interest expense, tax expense, and depreciation and amortization expenses for such period (the “Consolidated Total Leverage Ratio”). Base rate revolving loans bear interest on the outstanding principal amount thereof at a rate per annum equal to the highest of (i) Federal Funds rate plus 0.50%, (ii) the rate of interest in effect for such day as publicly announced from time to time by the Agent as its “prime rate”, and (iii) Eurodollar Rate plus 1.0% (the “Base Rate”), plus a margin ranging from 0.50% to 1.50%, based on its Consolidated Total Leverage Ratio.



(Refer to Note H - "Debt" of the condensed consolidated financial statements for a complete description of our 2018 Credit Facility.)

We had \$366.7 million in net availability under the 2018 Revolving Credit Facility at September 30, 2018. The outstanding borrowings under the 2018 Revolving Credit Facility include \$0.3 million of outstanding letters of credit at September 30, 2018.

#### Senior Notes

On April 18, 2018, we consummated the issuance and sale of \$400 million aggregate principal amount of our Senior Notes offered pursuant to a private offering to qualified institutional buyers in accordance with Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), and to non-U.S. persons under Regulation S under the Securities Act. We used the net proceeds from the sale of the Notes to repay debt under our existing credit facilities in connection with a concurrent refinancing transaction described above. The Notes were issued pursuant to an indenture, dated as of April 18, 2018 (the "Indenture"), between the Company and U.S. Bank National Association, as trustee (the "Trustee"). The Notes will bear interest at the rate of 8.000% per annum and will mature on May 1, 2026. Interest on the Notes is payable in cash on May 1st and November 1st of each year, beginning on November 1, 2018. The Notes are general senior unsecured obligations of the Company and are not guaranteed by our subsidiaries. The Indenture contains several restrictive covenants including, but not limited to, limitations on the following: (i) the incurrence of additional indebtedness, (ii) restricted payments, (iii) dividends and other payments affecting restricted subsidiaries, (iv) the issuance of preferred stock of restricted subsidiaries, (v) transactions with affiliates, (vi) asset sales and mergers and consolidations, (vii) future subsidiary guarantees and (viii) liens, subject in each case to certain exceptions.

The following table reflects required and actual financial ratios as of September 30, 2018 included as part of the affirmative covenants in our 2018 Credit Facility.

Description of Required Covenant Ratio	Covenant Ratio Requirement	Actual Ratio
Fixed Charge Coverage Ratio	Greater than or equal to 1.50:1.0	4:66:1.0
Total Secured Debt to EBITDA Ratio	Less than or equal to 3.50:1.0	2.49:1.0
Total Debt to EBITDA Ratio	Less than or equal to 5.00:1.0	3.85:1.0

#### Interest Expense

The components of interest expense and periodic interest charges on outstanding debt are as follows (in thousands):

	Nine months ended	
	September 30, 2018	September 30, 2017
Interest on credit facilities	\$23,293	\$18,008
Unused fee on Revolving Credit Facility	1,282	2,143
Amortization of original issue discount	576	781
Interest on Senior Notes	14,489	—
Unrealized (gain) loss on interest rate derivative <sup>(1)</sup>	(4,649)	1,178
Letter of credit fees	6	63
Other	524	414
Interest expense	\$35,521	\$22,587
Average daily balance of debt outstanding	\$953,152	\$593,314
Effective interest rate <sup>(1)</sup>	5.0	% 5.1 %

<sup>(1)</sup> On September 16, 2014, we purchased an interest rate swap (the "Swap") with a notional amount of \$220 million effective April 1, 2016 through June 6, 2021. The agreement requires us to pay interest on the notional amount at the rate of 2.97% in exchange for the three-month LIBOR rate. At September 30, 2018, the current portion of the Swap was in a liability position and had a fair value of \$0.5 million, and the non-current portion of the Swap was in an asset position with a fair value of \$0.5 million. The fair value of the Swap reflects the present value of future payments and



receipts under the agreement and is reflected as a component of interest expense and non-current assets and current liabilities at September 30, 2018.

#### Reconciliation of Non-GAAP Financial Measures

U.S. GAAP refers to generally accepted accounting principles in the United States. From time to time we may publicly disclose certain "non-GAAP" financial measures in the course of our investor presentations, earnings releases, earnings conference calls or other venues. A non-GAAP financial measure is a numerical measure of historical or future performance, financial position or cash flow that excludes amounts, or is subject to adjustments that effectively exclude amounts, included in the most directly comparable measure calculated and presented in accordance with GAAP in our financial statements, and vice versa for measures that include amounts, or are subject to adjustments that effectively include amounts, that are excluded from the most directly comparable measure as calculated and presented.

Non-GAAP financial measures are provided as additional information to investors in order to provide them with an alternative method for assessing our financial condition and operating results. These measures are not meant to be a substitute for GAAP, and may be different from or otherwise inconsistent with non-GAAP financial measures used by other companies.

The tables below reconcile the most directly comparable GAAP financial measures to Earnings before Interest, Income Taxes, Depreciation and Amortization ("EBITDA"), Adjusted EBITDA, and Cash Flow Available for Distribution and Reinvestment ("CAD").

#### Reconciliation of Net income (Loss) to EBITDA and Adjusted EBITDA

EBITDA – EBITDA is calculated as net income (loss) before interest expense, income tax expense (benefit), depreciation expense and amortization expense. Amortization expenses consist of amortization of intangibles and debt charges, including debt issuance costs, discounts, etc.

Adjusted EBITDA – Adjusted EBITDA is calculated utilizing the same calculation as described above in arriving at EBITDA further adjusted by: (i) noncontrolling stockholder compensation, which generally consists of non-cash stock option expense; (ii) successful acquisition costs, which consist of transaction costs (legal, accounting, due diligence, etc.) incurred in connection with the successful acquisition of a business expensed during the period in compliance with ASC 805; (iii) management fees, which reflect fees due quarterly to our Manager in connection with our MSA, as well as Integration Services Fees paid by newly acquired companies; (iv) impairment charges, which reflect write downs to goodwill or other intangible assets; (v) gains or losses recorded in connection with our investment; (vi) gains or losses recorded in connection with the sale of fixed assets and (vii) foreign currency transaction gains or losses incurred in connection with the conversion of intercompany debt from a foreign functional currency to U.S. dollar. We believe that EBITDA and Adjusted EBITDA provide useful information to investors and reflect important financial measures as they exclude the effects of items which reflect the impact of long-term investment decisions, rather than the performance of near term operations. When compared to income (loss) from continuing operations these financial measures are limited in that they do not reflect the periodic costs of certain capital assets used in generating revenues of our businesses or the non-cash charges associated with impairments. This presentation also allows investors to view the performance of our businesses in a manner similar to the methods used by us and the management of our businesses, provides additional insight into our operating results and provides a measure for evaluating targeted businesses for acquisition.

We believe that these measurements are also useful in measuring our ability to service debt and other payment obligations. EBITDA and Adjusted EBITDA are not meant to be a substitute for GAAP, and may be different from or otherwise inconsistent with non-GAAP financial measures used by other companies.

The following tables reconcile EBITDA and Adjusted EBITDA to net income (loss), which we consider to be the most comparable GAAP financial measure (in thousands):



Edgar Filing: Compass Diversified Holdings - Form 10-Q

Adjusted EBITDA

Nine months ended September 30, 2018

	Corporate	5.11	Ergobaby	Liberty	Manitoba Harvest	Velocity Outdoor	ACI	Arnold	Clean Earth	Foam	Sterno	C
Net income (loss)	\$(3,216 )	\$(9,612 )	\$4,550	\$1,282	\$(3,349)	\$(934 )	\$10,646	\$(330 )	\$2,229	\$530	\$2,882	\$
Adjusted for:												
Provision (benefit) for income taxes	—	(586 )	1,697	420	(1,163 )	(736 )	2,790	2,446	(2,247 )	689	837	4
Interest expense, net	34,980	13	1	—	10	235	(2 )	—	228	—	—	3
Intercompany interest	(72,887 )	12,904	3,661	3,139	3,732	6,401	5,605	4,660	11,844	5,898	15,043	—
Depreciation and amortization	1,620	16,201	6,397	1,190	4,884	6,252	2,497	4,789	17,781	7,912	21,758	9
EBITDA	(39,503 )	18,920	16,306	6,031	4,114	11,218	21,536	11,565	29,835	15,029	40,520	1
Gain on sale of business	(1,165 )	—	—	—	—	—	—	—	—	—	—	(1
(Gain) loss on sale of fixed assets	—	(259 )	—	59	13	—	—	48	53	72	—	(1
Noncontrolling shareholder compensation	—	1,903	733	37	557	1,074	18	117	1,165	594	1,496	7
Acquisition expenses and other	5	—	—	—	—	1,362	—	—	1,444	1,552	632	4
Integration services fee	—	—	—	—	—	750	—	—	—	1,406	—	2
Loss on foreign currency transaction and other	1,364	—	—	—	—	—	—	—	—	—	—	1
Management fees	28,734	750	375	375	263	375	375	375	375	470	375	3
Adjusted EBITDA	\$(10,565)	\$21,314	\$17,414	\$6,502	\$4,947	\$14,779	\$21,929	\$12,105	\$32,872	\$19,123	\$43,023	\$

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Adjusted EBITDA

Nine months ended September 30, 2017

	Corporate	5.11	Ergo	Liberty	Manitoba Harvest	Velocity Outdoor	ACI	Arnold	Clean Earth	Foam	Sterno
Net income (loss)	\$(5,407)	\$(15,043)	\$5,364	\$2,522	\$(2,505)	\$(3,375)	\$8,839	\$(10,282)	\$(1,980)		\$6,348
Adjusted for:											
Provision (benefit) for income taxes	—	(10,405)	3,941	1,351	(944)	(962)	2,755	270	(1,041)		3,034
Interest expense, net	22,154	51	—	—	37	23	(11)	—	245		—
Intercompany interest	(49,297)	10,697	4,628	2,989	3,211	2,561	6,194	5,194	10,108		3,715
Depreciation and amortization	1,392	35,233	10,002	1,359	5,011	5,932	2,716	5,238	16,502		8,995
EBITDA	(31,158)	20,533	23,935	8,221	4,810	4,179	20,493	420	23,834		22,092
Gain on sale of businesses	(340)	—	—	—	—	—	—	—	—		—
(Gain) loss on sale of fixed assets	—	—	—	46	(227)	—	(10)	(9)	(56)		486
Noncontrolling shareholder compensation	—	1,786	521	7	750	—	18	149	1,166	Not Applicable	555
Impairment expense	—	—	—	—	—	—	—	8,864	—		—
Acquisition related expenses	—	—	—	—	—	1,836	—	—	—		—
Integration services fee	—	2,333	—	—	—	375	—	—	—		—
Gain on equity investment	5,620	—	—	—	—	—	—	—	—		—
Gain on foreign currency transaction and other	(3,583)	—	—	—	—	—	—	—	—		—
Management fees	20,881	750	375	375	262	165	375	375	375		375
Adjusted EBITDA	\$(8,580)	\$25,402	\$24,831	\$8,649	\$5,595	\$6,555	\$20,876	\$9,799	\$25,319		\$23,508



## Cash Flow Available for Distribution and Reinvestment

The table below details cash receipts and payments that are not reflected on our income statement in order to provide an additional measure of management's estimate of cash available for distribution ("CAD"). CAD is a non-GAAP measure that we believe provides additional, useful information to our shareholders in order to enable them to evaluate our ability to make anticipated quarterly distributions. CAD is not meant to be a substitute for GAAP, and may be different from or otherwise inconsistent with non-GAAP financial measures used by other companies. The following table reconciles CAD to net income (loss) and cash flows provided by operating activities, which we consider to be the most directly comparable financial measure calculated and presented in accordance with GAAP.

(in thousands)	Nine Months Ended	
	September 30, 2018	September 30, 2017
Net income (loss)	\$4,678	\$(15,519)
Adjustment to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	87,878	88,659
Impairment expense	—	8,864
Gain on sale of businesses	(1,165)	(340)
Amortization of debt issuance costs and original issue discount	3,403	3,721
Unrealized (gain) loss on interest rate hedges	(4,649)	1,178
Loss on equity method investment	—	5,620
Noncontrolling shareholder charges	7,694	4,952
Excess tax benefit from subsidiary stock options exercised	—	(417)
Provision for loss on receivables	459	4,310
Deferred taxes	(6,622)	(17,937)
Other	46	494
Changes in operating assets and liabilities	(32,950)	(24,349)
Net cash provided by operating activities	58,772	59,236
Plus:		
Unused fee on revolving credit facility	1,282	2,143
Integration services fee <sup>(1)</sup>	2,156	2,708
Successful acquisition costs	4,995	1,836
Realized loss from foreign currency <sup>(2)</sup>	1,364	—
Excess tax benefit from subsidiary stock options exercised	—	417
Changes in operating assets and liabilities	32,950	24,349
Other	885	—
Less:		
Payment of interest rate swap	1,444	3,050
Maintenance capital expenditures: <sup>(3)</sup>		
Compass Group Diversified Holdings LLC	—	—
5.11 Tactical	2,629	2,914
Advanced Circuits	1,169	219
Arnold	3,160	2,548
Clean Earth	5,998	3,591
Ergobaby	646	788
Foam Fabricators	1,455	—
Liberty	1,039	389
Manitoba Harvest	342	625
Sterno	2,320	1,373
Velocity Outdoor	3,063	968
Realized gain from foreign currency <sup>(2)</sup>	—	3,583
Other <sup>(4)</sup>	—	3,980

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Preferred share distribution	8,398	—
Estimated cash flow available for distribution and reinvestment	\$70,741	\$66,661

67

---

Distribution paid in April 2018/2017	\$(21,564)	\$(21,564)
Distribution paid in July 2018/2017	(21,564 )	(21,564 )
Distribution paid in October 2018/2017	(21,564 )	(21,564 )
	\$(64,692)	\$(64,692)

(1) Represents fees paid by newly acquired companies to the Manager for integration services performed during the first year of ownership, payable quarterly.

(2) Reflects the foreign currency transaction gain or loss resulting from the Canadian dollar intercompany loans issued to Manitoba Harvest.

(3) Represents maintenance capital expenditures that were funded from operating cash flow, net of proceeds from the sale of property, plant and equipment, and excludes growth capital expenditures of approximately \$19.2 million for the nine months ended September 30, 2018 and \$17.5 million for the nine months ended September 30, 2017.

(4) Includes amounts for the establishment of accounts receivable reserves related to two retail customers who filed for bankruptcy during 2017.

#### Seasonality

Earnings of certain of our operating segments are seasonal in nature. Earnings from Liberty are typically lowest in the second quarter due to lower demand for safes at the onset of summer. Velocity Outdoor typically has higher sales in the third and fourth quarter each year, reflecting the hunting and holiday seasons. Earnings from Clean Earth are typically lower during the winter months due to the limits on outdoor construction and development activity because of the colder weather in the Northeastern United States. Sterno typically has higher sales in the second and fourth quarter of each year, reflecting the outdoor summer and holiday seasons, respectively.

#### Related Party Transactions

##### Integrations Services Agreements

Foam Fabricators, which was acquired in 2018, and Velocity Outdoor, which was acquired in 2017, entered into Integration Services Agreements ("ISA") with CGM. The ISA provides for CGM to provide services for new platform acquisitions to, amongst other things, assist the management at the acquired entities in establishing a corporate governance program, implement compliance and reporting requirements of the Sarbanes-Oxley Act and align the acquired entity's policies and procedures with our other subsidiaries. Each ISA is for the twelve-month period subsequent to the acquisition. Velocity Outdoor paid CGM \$0.75 million in integration services fees during 2017 and \$0.75 million in integration services fees in 2018. Foam Fabricators will pay CGM \$2.25 million over the term of the ISA, \$2.0 million in 2018 and \$0.25 million in 2019.

##### Sterno Recapitalization

In January 2018, the Company completed a recapitalization at Sterno whereby the Company entered into an amendment to the intercompany loan agreement with Sterno (the "Sterno Loan Agreement"). The Sterno Loan Agreement was amended to (i) provide for term loan borrowings of \$57.7 million to fund a distribution to the Company, which owned 100% of the outstanding equity of Sterno at the time of the recapitalization, and (ii) extend the maturity dates of the term loans. In connection with the recapitalization, Sterno's management team exercised all of their vested stock options, which represented 58,000 shares of Sterno. The Company then used a portion of the distribution to repurchase the 58,000 shares from management for a total purchase price of \$6.0 million. In addition, Sterno issued new stock options to replace the exercised options, thus maintaining the same percentage of fully diluted non-controlling interest that existed prior to the recapitalization.

#### 5.11 - Related Party Vendor Purchases

5.11 purchases inventory from a vendor who is a related party to 5.11 through one of the executive officers of 5.11 via the executive's 40% ownership interest in the vendor. During the three and nine months ended September 30, 2018, 5.11 purchased approximately \$0.9 million and \$2.9 million, respectively, in inventory from the vendor.

#### Off-Balance Sheet Arrangements

We have no special purpose entities or off-balance sheet arrangements, other than operating leases entered into in the ordinary course of business.



### Contractual Obligations

Long-term contractual obligations, except for our long-term debt obligations, are generally not recognized in our consolidated balance sheet. Non-cancelable purchase obligations are obligations we incur during the normal course of business, based on projected needs.

The table below summarizes the payment schedule of our contractual obligations at September 30, 2018:

(in thousands)	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations <sup>(1)</sup>	\$1,526,473	\$33,196	\$120,800	\$353,746	\$1,018,731
Operating lease obligations <sup>(2)</sup>	137,762	22,324	42,974	28,607	43,857
Purchase obligations <sup>(3)</sup>	426,929	245,766	103,297	74,174	3,692
Total <sup>(4)</sup>	\$2,091,164	\$301,286	\$267,071	\$456,527	\$1,066,280

(1) Reflects amounts due under our 2018 Credit Facility, as well as our Senior Notes, together with interest on our debt obligations.

(2) Reflects various operating leases for office space, manufacturing facilities and equipment from third parties with various lease terms.

Reflects non-cancelable commitments as of September 30, 2018, including: (i) shareholder distributions of \$93.5 million over the next year; (ii) estimated management fees of \$36.4 million per year over the next five years; and

(3) (iii) other obligations including amounts due under employment agreements. Distributions to our shareholders are approved by our board of directors each quarter. The amount ultimately approved as future quarterly distributions may differ from the amount included in this schedule.

The contractual obligation table does not include approximately \$1.1 million in liabilities associated with

(4) unrecognized tax benefits as of September 30, 2018 as the timing of the recognition of this liability is not certain.

The amount of the liability is not expected to significantly change in the next twelve months.

### Critical Accounting Estimates

The preparation of our financial statements in conformity with GAAP requires management to adopt accounting policies and make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates under different assumptions and judgments and uncertainties, and potentially could result in materially different results under different conditions. These critical accounting estimates are reviewed periodically by our independent auditors and the audit committee of our board of directors.

Except as set forth below, our critical accounting estimates have not changed materially from those disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K, for the year ended December 31, 2017, as filed with the Securities and Exchange Commission ("SEC") on February 28, 2018.

### Goodwill and Indefinite-lived Intangible Asset Impairment Testing

#### Goodwill

Goodwill represents the excess amount of the purchase price over the fair value of the assets acquired. Our goodwill and indefinite lived intangible assets are tested for impairment on an annual basis as of March 31<sup>st</sup>, and if current events or circumstances require, on an interim basis. Goodwill is allocated to various reporting units, which are generally an operating segment or one level below the operating segment. Each of our businesses represents a reporting unit except Arnold, which we determined comprised three reporting units when it was acquired in March 2012. As a result of changes implemented by Arnold management during 2016 and 2017, we reassessed the reporting units at Arnold as of the annual impairment testing date in 2018. After evaluating changes in the operation of the reporting units that led to increased integration and altered how the financial results of the Arnold operating segment were assessed by Arnold management, the Company determined that the previously identified reporting units no longer operate in the same manner as they did when the Company acquired Arnold. As a result, the separate Arnold reporting units were determined to only comprise one reporting unit at the Arnold operating segment level as of March 31, 2018. As part of the exercise of combining the separate Arnold reporting units into one reporting unit, we



performed "before" and "after" goodwill impairment testing, whereby we performed the annual impairment testing for each of the existing reporting units of Arnold and then subsequent to the completion of the annual impairment testing of the separate

reporting units, we performed a quantitative impairment test of the Arnold operating segment, which will represent the reporting unit for future impairment tests.

We use a qualitative approach to test goodwill for impairment by first assessing qualitative factors to determine whether it is more-likely than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment testing. The qualitative factors we consider include, in part, the general macroeconomic environment, industry and market specific conditions for each reporting unit, financial performance including actual versus planned results and results of relevant prior periods, operating costs and cost impacts, as well as issues or events specific to the reporting unit. As part of the assessment of the Arnold reporting units at March 31, 2018, we performed impairment testing on the three separate reporting units. Two of the Arnold reporting units, PMAG and PTM, were tested qualitatively, while a quantitative impairment test was performed on the Flexmag reporting unit because we could not determine that it was more-likely than-not that the fair value of a reporting unit exceeded its carrying value. We then performed a quantitative impairment test of the Arnold operating segment, which combined the three reporting units. The results of the quantitative impairment testing of the Arnold reporting unit indicated that the fair value of the Arnold reporting unit exceeded the carrying value by 254%. For the reporting units that were tested qualitatively, the results of the qualitative analysis indicated that the fair value exceeded their carrying value.

#### 2017 Interim Impairment Testing

As a result of operating results that were below forecasted amounts, as well as a failure of the financial covenants associated with the intercompany credit facility, we determined that a triggering event had occurred at Manitoba Harvest in the fourth quarter of 2017. We performed impairment testing of the goodwill and the indefinite lived tradename at Manitoba Harvest as of December 31, 2017. For the quantitative impairment test at Manitoba Harvest, we utilized an income approach. The weighted average cost of capital used in the income approach at Manitoba Harvest was 11.7%. Under the new guidance, a goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Results of the quantitative testing of Manitoba Harvest indicated that the carrying value of Manitoba Harvest exceeded its fair value by \$6.3 million, and we recorded \$6.2 million (after the effect of foreign currency translation) as impairment expense at December 31, 2017. For the indefinite lived trade name, quantitative testing of the Manitoba Harvest tradename indicated that the carrying value exceeded its fair value by \$2.3 million, and we recorded \$2.3 million (after the effect of foreign currency translation) of impairment expense at December 31, 2017. We finalized the Manitoba Harvest impairment testing during the first quarter of 2018 with no changes to the original estimate.

#### 2017 Annual Impairment Testing

At March 31, 2017, we determined that the Manitoba Harvest reporting unit required further quantitative testing because we could not conclude that the fair value of the reporting unit exceeds its carrying value based on qualitative factors alone. For the quantitative impairment test at Manitoba Harvest, the Company utilized an income approach. The weighted average cost of capital used in the income approach at Manitoba Harvest was 12.0%. Results of the quantitative testing of Manitoba Harvest indicated that the fair value of Manitoba Harvest exceeded its carrying value. For the reporting units that were tested qualitatively, the results of the qualitative analysis indicated that the fair value of those reporting units exceeded their carrying value.

#### Indefinite-lived intangible assets

We use a qualitative approach to test indefinite lived intangible assets for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform quantitative impairment testing. Our indefinite-lived intangible assets consist of trade names with a carrying value of approximately \$70.9 million. The Manitoba Harvest trade name was tested for impairment as part of the interim impairment testing for Manitoba Harvest at December 31, 2017 as noted above. The results of the qualitative analysis of our other reporting unit's indefinite-lived intangible assets, which we completed as of March 31, 2018, indicated that the fair value of the indefinite lived intangible assets exceeded their carrying value.

#### Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board ("FASB") issued a comprehensive new revenue recognition standard. The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising

from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. In addition, the standard requires disclosure of the amount, timing and uncertainty of cash flows arising from contracts with customers. The new standard, and all related amendments, was effective for us beginning January

70

---

1, 2018 and was adopted using the modified retrospective method for all contracts not completed as of the date of adoption.

The reported results for reporting periods after January 1, 2018 are presented under the new revenue recognition guidance while prior period amounts were prepared under the previous revenue guidance which is also referred to herein as the "previous guidance". We determined that the impact from the new standard is immaterial to our revenue recognition model since the vast majority of our recognition is based on point in time control. Accordingly, we have not made any adjustments to opening retained earnings.

The adoption of the new revenue guidance represents a change in accounting principle that will more closely align revenue recognition with the transfer of control of our goods and services and will provide financial statement readers with enhanced disclosures. In accordance with the new revenue guidance, revenue is recognized when a customer obtains control of promised goods or services. The amount of revenue recognized reflects the consideration to which we expect to be entitled to receive in exchange for these goods or services, and excludes any sales incentives or taxes collected from customers which are subsequently remitted to government authorities. The impacts from the adoption of the new revenue guidance primarily relates to the timing of revenue recognition for variable consideration received, consideration payable to a customer and recording right of return assets. Although these differences have been identified, the total impact to each reportable segment will not be material to the consolidated financial statements. In addition, the accounting for the estimate of variable consideration in our contracts is not materially different compared to our current practice. The Company has established monitoring controls to identify new sales arrangements and changes in our business environment that could impact our current accounting assessment.

#### Recent Accounting Pronouncements

Refer to Note A - "Presentation and Principles of Consolidation" of the condensed consolidated financial statements for a discussion of recent accounting pronouncements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes to our market risk since December 31, 2017. For a further discussion of our exposure to market risk, refer to the section entitled "Quantitative and Qualitative Disclosures about Market Risk" that was disclosed in Part II, Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on February 28, 2018.

### ITEM 4. CONTROLS AND PROCEDURES

As required by Securities Exchange Act of 1934, as amended (the "Exchange Act") Rule 13a-15(b), Holdings' Regular Trustees and the Company's management, including the Chief Executive Officer and Chief Financial Officer of the Company, conducted an evaluation of the effectiveness of Holdings' and the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)), as of September 30, 2018. Based on that evaluation, the Holdings' Regular Trustees and the Chief Executive Officer and Chief Financial Officer of the Company concluded that Holdings' and the Company's disclosure controls and procedures were effective as of September 30, 2018.

There have been no material changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during our most recently completed fiscal quarter, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II  
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There have been no material changes to those legal proceedings associated with the Company's and Holdings' business together with legal proceedings for the businesses discussed in the section entitled "Legal Proceedings" that was disclosed in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on February 28, 2018.

ITEM 1A. RISK FACTORS

There have been no material changes in those risk factors and other uncertainties associated with the Company and Holdings discussed in the section entitled "Risk Factors" that was disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC on February 28, 2018.

ITEM 6. EXHIBITS

Exhibit Number Description

12.1*	Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Distributions
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant
32.1**	Certification of Chief Executive Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2**	Certification of Chief Financial Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 34-47986, the certifications furnished in Exhibit 32.1 and Exhibit 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed + "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMPASS DIVERSIFIED  
HOLDINGS

By: /s/ Ryan J. Faulkingham  
Ryan J. Faulkingham  
Regular Trustee

Date: 10/31/2018

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COMPASS GROUP DIVERSIFIED HOLDINGS  
LLC

By: /s/ Ryan J. Faulkingham  
Ryan J. Faulkingham  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

Date: 10/31/2018

EXHIBIT INDEX

Description

12.1\* Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Distributions

31.1\* Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant

31.2\* Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant

32.1\*\*+ Certification of Chief Executive Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2\*\*+ Certification of Chief Financial Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS\* XBRL Instance Document

101.SCH\* XBRL Taxonomy Extension Schema Document

101.CAL\* XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF\* XBRL Taxonomy Extension Definition Linkbase Document

101.LAB\* XBRL Taxonomy Extension Label Linkbase Document

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 34-47986, the certifications furnished in Exhibit 32.1 and Exhibit 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed<sup>+</sup> "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act.