

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Compass Diversified Holdings
Form 10-Q
May 01, 2019

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 March 31, 2019

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 Exchange Act.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

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

As of April 30, 2019, 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 March 31, 2019
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>	7
<u>CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)</u>	8
<u>CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY</u>	9
<u>CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS</u>	10
<u>NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	12
ITEM 2. <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	35
ITEM 3. <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	57
ITEM 4. <u>CONTROLS AND PROCEDURES</u>	57
PART II. OTHER INFORMATION	
ITEM 1. <u>LEGAL PROCEEDINGS</u>	58
ITEM 1A. <u>RISK FACTORS</u>	58
ITEM 6. <u>EXHIBITS</u>	58
<u>SIGNATURES</u>	59

NOTE TO READER

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

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

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

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

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, entered into on June 14, 2014 with a group of lenders led by Bank of America N.A. as administrative agent, as amended from time to time, which provides for a Revolving Credit Facility and a Term Loan;

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

	March 31, 2019	December 31, 2018
(in thousands)	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 39,837	\$ 50,749
Accounts receivable, net	263,494	265,234
Inventories	313,910	307,437
Prepaid expenses and other current assets	87,964	35,810
Current assets of discontinued operations	—	21,955
Total current assets	705,205	681,185
Property, plant and equipment, net	203,549	208,661
Operating lease right-of-use assets	103,442	—
Goodwill	611,883	615,893
Intangible assets, net	733,347	745,121
Other non-current assets	12,200	12,008
Non-current assets of discontinued operations	—	109,467
Total assets	\$ 2,369,626	\$ 2,372,335

COMPASS DIVERSIFIED HOLDINGS
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)	March 31, 2019 (Unaudited)	December 31, 2018
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 91,341	\$ 103,304
Accrued expenses	115,824	123,120
Due to related party	10,609	11,093
Current portion, long-term debt	5,000	5,000
Current portion, operating lease liabilities	19,574	—
Other current liabilities	7,764	7,334
Current liabilities of discontinued operations	—	9,429
Total current liabilities	250,112	259,280
Deferred income taxes	61,023	62,284
Long-term debt	955,395	1,098,871
Operating lease liabilities	90,701	—
Other non-current liabilities	11,614	17,790
Non-current liabilities of discontinued operations	—	14,768
Total liabilities	1,368,845	1,452,993

Commitments and contingencies

Stockholders' equity

Trust preferred shares, 50,000 authorized; 8,000 shares issued and outstanding at March 31, 2019 at December 31, 2018

Series A preferred shares, no par value;

4,000 shares issued and outstanding at March 31, 2019 and December 31, 2018

Series B preferred shares, no par value;

4,000 shares issued and outstanding at March 31, 2019 and December 31,

96,417

96,417

96,504

96,504

Edgar Filing: Compass Diversified Holdings - Form 10-Q

2018

Trust common shares, no
par value, 500,000
authorized; 59,900
shares issued and
outstanding at March 31,
2019 and December 31,
2018

924,680		924,680	
(3,517)	(8,776)
(165,490)	(249,453)
948,594		859,372	
52,187		48,810	
—		11,160	
1,000,781		919,342	
\$	2,369,626	\$	2,372,335

See notes to condensed consolidated financial statements.

6

COMPASS DIVERSIFIED HOLDINGS
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended March 31,	
(in thousands, except per share data)	2019	2018
Net revenues	\$402,489	\$344,352
Cost of revenues	266,300	225,186
Gross profit	136,189	119,166
Operating expenses:		
Selling, general and administrative expense	93,199	91,300
Management fees	11,082	10,762
Amortization expense	17,040	11,537
Operating income	14,868	5,567
Other income (expense):		
Interest expense, net	(18,582)	(6,182)
Loss on sale of securities (refer to Note C)	(5,300)	—
Amortization of debt issuance costs	(927)	(1,098)
Other income (expense), net	(571)	(1,374)
Loss from continuing operations before income taxes	(10,512)	(3,087)
Provision (benefit) for income taxes	403	(1,860)
Loss from continuing operations	(10,915)	(1,227)
Loss from discontinued operations, net of income tax	(586)	(394)
Gain on sale of discontinued operations	121,659	—
Net income (loss)	110,158	(1,621)
Less: Net income from continuing operations attributable to noncontrolling interest	1,300	359
Less: Net income (loss) from discontinued operations attributable to noncontrolling interest	(450)	361
Net income (loss) attributable to Holdings	\$109,308	\$(2,341)
Amounts attributable to Holdings		
Loss from continuing operations	\$(12,215)	\$(1,586)
Loss from discontinued operations, net of income tax	\$(136)	\$(755)
Gain on sale of discontinued operations, net of income tax	121,659	—
Net income (loss) attributable to Holdings	\$109,308	\$(2,341)
Basic income (loss) per common share attributable to Holdings (refer to Note J)		
Continuing operations	\$(0.31)	\$(0.08)
Discontinued operations	2.03	(0.01)
	\$1.72	\$(0.09)
Basic weighted average number of shares of common shares outstanding	59,900	59,900
Cash distributions declared per Trust common share (refer to Note J)	\$0.36	\$0.36

See notes to condensed consolidated financial statements.

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

(in thousands)	Three months ended March 31,	
	2019	2018
Net income (loss)	\$ 110,158	\$(1,621)
Other comprehensive income (loss)		
Foreign currency translation adjustments	577	(1,023)
Foreign currency amounts reclassified from accumulated other comprehensive income (loss) that increase (decrease) net income:		
Disposition of Manitoba Harvest	4,791	—
Pension benefit liability, net	(109)	441
Other comprehensive income (loss)	5,259	(582)
Total comprehensive income (loss), net of tax	\$ 115,417	\$(2,203)
Less: Net income attributable to noncontrolling interests	850	720
Less: Other comprehensive income attributable to noncontrolling interests	2	354
Total comprehensive income (loss) attributable to Holdings, net of tax	\$ 114,565	\$(3,277)

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	Non-Controlling Interest Attributable to Disc. Ops.	Total Stockholders' Equity
	Series A	Series B							
Balance — January 1, 2018	\$96,417	\$—	\$924,680	\$(145,316)	\$(2,573)	\$873,208	\$41,066	\$11,725	\$925,999
Net income (loss)	—	—	—	(2,341)	—	(2,341)	359	361	(1,621)
Total comprehensive loss, net	—	—	—	—	(582)	(582)	—	—	(582)
Issuance of Trust preferred shares, net of offering costs	—	96,713	—	—	—	96,713	—	—	96,713
Option activity attributable to noncontrolling shareholders	—	—	—	—	—	—	2,551	—	2,551
Effect of subsidiary stock option exercise	—	—	—	—	—	—	(6,392)	—	(6,392)
Distributions paid - Trust Common Shares	—	—	—	(21,564)	—	(21,564)	—	—	(21,564)
Distributions paid - Trust Preferred Shares	—	—	—	(1,813)	—	(1,813)	—	—	(1,813)
Balance — March 31, 2018	\$96,417	\$96,713	\$924,680	\$(171,034)	\$(3,155)	\$943,621	\$37,584	\$12,086	\$993,291
Balance — January 1, 2019	\$96,417	\$96,504	\$924,680	\$(249,453)	\$(8,776)	\$859,372	\$48,810	\$11,160	\$919,342
Net income (loss)	—	—	—	109,308	—	109,308	1,300	(450)	110,158
Total comprehensive income, net	—	—	—	—	5,259	5,259	—	—	5,259
Option activity attributable to noncontrolling shareholders	—	—	—	—	—	—	2,116	89	2,205
Purchase of noncontrolling	—	—	—	—	—	—	(39)	—	(39)

Edgar Filing: Compass Diversified Holdings - Form 10-Q

interest									
Disposition of Manitoba Harvest Distributions paid - Trust Common Shares Distributions paid - Trust Preferred Shares	—	—	—	—	—	—	—	(10,799)	(10,799)
Balance — March 31, 2019	\$96,417	\$96,504	\$924,680	\$(165,490)	\$(3,517)	\$948,594	\$52,187	\$—	\$1,000,781

See notes to condensed consolidated financial statements.

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

	Three months ended March 31,	
(in thousands)	2019	2018
Cash flows from operating activities:		
Net income (loss)	\$ 110,158	\$(1,621)
Loss from discontinued operations, net of income tax	(586)	(394)
Gain on sale of discontinued operations	121,659	—
Net loss from continuing operations	(10,915)	(1,227)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation expense	10,581	9,104
Amortization expense	17,040	12,208
Amortization of debt issuance costs and original issue discount	1,079	1,353
Unrealized (gain) loss on interest rate swap	1,099	(2,901)
Noncontrolling stockholder stock based compensation	2,116	2,340
Provision for loss on receivables	696	328
Deferred taxes	(1,626)	(3,644)
Other	392	(228)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	958	(3,314)
Inventories	(6,624)	(5,465)
Other current and non-current assets	(2,735)	(4,644)
Accounts payable and accrued expenses	(20,969)	2,879
Cash provided by (used in) operating activities - continuing operations	(8,908)	6,789
Cash used in operating activities - discontinued operations	(28)	(146)
Cash provided by (used in) operating activities	(8,936)	6,643
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(878)	(402,770)
Purchases of property and equipment	(7,528)	(12,128)
Payment of interest rate swap	(94)	(706)
Proceeds from sale of business	124,166	—
Other investing activities	1,777	68
Cash provided by (used in) investing activities - continuing operations	117,443	(415,536)
Cash provided by (used in) investing activities - discontinued operations	51,501	(92)
Cash provided by (used in) investing activities	168,944	(415,628)

COMPASS DIVERSIFIED HOLDINGS
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)	Three months ended March 31,	
	2019	2018
Cash flows from financing activities:		
Proceeds from the issuance of Trust preferred shares, net	—	96,713
Borrowings under credit facility	49,000	465,500
Repayments under credit facility	(193,250)	(118,421)
Distributions paid - common shares	(21,564)	(21,564)
Distributions paid - preferred shares	(3,781)	(1,813)
Repurchase of subsidiary stock	—	(6,392)
Purchase of noncontrolling interest	(39)	—
Debt issuance costs	—	(138)
Other	(2,814)	(467)
Net cash provided by (used in) financing activities	(172,448)	413,418
Foreign currency impact on cash	(1,049)	2,007
Net increase (decrease) in cash and cash equivalents	(13,489)	6,440
Cash and cash equivalents — beginning of period	53,326	39,885
Cash and cash equivalents — end of period	\$39,837	\$46,325

⁽¹⁾ Includes cash from discontinued operations of \$2.6 million at January 1, 2019 and \$1.3 million at January 1, 2018.

See notes to condensed consolidated financial statements.

COMPASS DIVERSIFIED HOLDINGS
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
March 31, 2019

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 nine businesses, or reportable operating segments, at March 31, 2019. 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"), 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 The Sterno Group, LLC ("Sterno"). Refer to Note E - "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 month periods ended March 31, 2019 and March 31, 2018 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, 2018.

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

During the first quarter of 2019, the Company completed the sale of Fresh Hemp Foods Ltd. ("Manitoba Harvest"). The results of operations of Manitoba Harvest are reported as discontinued operations in the condensed consolidated statements of operations for the three months ended March 31, 2019. Refer to Note C - "Discontinued Operations" for additional information. Unless otherwise indicated, the disclosures accompanying the condensed consolidated financial statements reflect the Company's continuing operations.

Seasonality

Earnings of certain of our operating segments are seasonal in nature due to various recurring events, holidays and seasonal weather patterns, as well as the timing of our acquisitions during a given year. Historically, the third and fourth quarter produce the highest net sales during our fiscal year.

Recently Adopted Accounting Pronouncements

Leases

As of January 1, 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, Leases ("Topic 842"). The new standard requires 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. In July 2018, the Financial Accounting Standards Board ("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 adopted the new standard using the optional transition method. The reported results for reporting periods after January 1, 2019 are presented under the new lease guidance while prior period amounts were prepared under the previous lease guidance.

The new standard provides a number of optional practical expedients in transition. The Company elected to use the package of practical expedients that allows us to not reassess: (i) whether any expired or existing contracts are or contain leases, (ii) lease classification for any expired or existing leases and (iii) initial direct costs for any expired or existing leases. We additionally elected to use the practical expedient that allows lessees to treat the lease and non-lease components of leases as a single lease component and the practical expedient pertaining to land easements. In addition, the new standard provides for an accounting election that permits a lessee to elect not to apply the recognition requirements of Topic 842 to short-term leases by class of underlying asset. The Company adopted this accounting election for all classes of assets.

The Company has performed an assessment of the impact of the adoption of Topic 842 on the Company's consolidated financial position and results of operations for the Company's leases, which consist of manufacturing facilities, warehouses, office facilities, retail stores, equipment and vehicle leases. The adoption of the new lease standard on January 1, 2019 resulted in the recognition of right-of-use assets of approximately \$106.9 million and lease liabilities for operating leases of approximately \$115.4 million on our Consolidated Balance Sheets, with no material impact to its Consolidated Statements of Operations or Consolidated Statement of Cash Flows. We implemented processes and a lease accounting system to ensure adequate internal controls were in place to assess our leasing arrangements and enable proper accounting and reporting of financial information upon adoption. No cumulative effect adjustment was recognized as the amount was not material. Refer to "Note O - Commitments and Contingencies" for additional information regarding the Company's adoption of Topic 842.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments—Credit Losses, which will require companies to present assets held at amortized cost and available for sale debt securities net of the amount expected to be collected. The guidance requires the measurement of expected credit losses to be based on relevant information from past events, including historical experiences, current conditions and reasonable and supportable forecasts that affect collectibility. The guidance will be effective for fiscal years and interim periods beginning after December 15, 2019 and early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

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 provided integration services during the first year of the Company's ownership. CGM received integration service fees of \$2.25 million payable over a twelve month period as services were rendered. 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 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 allocation of the purchase price, which was finalized during the fourth quarter of 2018, was based upon 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 were 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 were estimated at their 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. Goodwill was calculated as the excess of the consideration transferred over the fair value of the identifiable net assets 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 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. The purchase price of Rimports included 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 \$4.8 million. Sterno funded the acquisition through their intercompany credit facility with the Company. The transaction was accounted for as a business combination. 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 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 allocation of the purchase price, which was finalized during the fourth quarter of 2018, was based upon 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 were 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 were estimated at their 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. Goodwill was calculated as the excess of the consideration transferred over the fair value of the identifiable net assets 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 tradename was valued at \$6.6 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 \$79.1 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.

Unaudited pro forma information

The following unaudited pro forma data for the three months ended March 31, 2018 gives effect to the acquisition of Foam Fabricators and Sterno's acquisition of Rimports, as described above, and the disposition of Manitoba Harvest, as if these transactions had been completed as of January 1, 2018. 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 ended March 31, 2018
Net revenues	\$384,180
Gross profit	129,584
Operating income	8,697
Net loss	(2,847)
Net loss attributable to Holdings	(3,206)
Basic and fully diluted net loss per share attributable to Holdings	\$(0.11)

Other acquisitions

Clean Earth

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 \$31.0 million. In connection with the acquisition, Clean Earth recorded a purchase price allocation of approximately \$12.5 million in goodwill, and \$10.4 million in intangible assets. The Company finalized the purchase price in the fourth quarter of 2018.

DART - On September 5, 2018, Clean Earth acquired the assets of Disposal and Recycling Technologies, Inc. ("DART"), for a purchase price of approximately \$18.7 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. In connection with the acquisition, Clean Earth recorded \$5.0 million in intangible assets and \$8.3 million in goodwill.

Velocity Outdoor

Ravin Crossbows - On September 4, 2018, Velocity Outdoor (formerly Crosman Corp.) acquired all of the outstanding membership interests in Ravin Crossbows, LLC ("Ravin" or "Ravin Crossbows") 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 recorded a purchase price allocation for Ravin comprised of \$67.5 million in intangible assets (\$14.1 million in finite lived trade name, \$42.6 million in technologies valued using an excess earnings methodology, and \$10.8 million in customer relationships), \$2.5 million in inventory step-up, and \$13.3 million in goodwill which is expected to be deductible for income tax purposes. The remainder of the purchase consideration was allocated to net assets acquired. The potential earn-out was valued at \$4.7 million as part of the purchase price allocation. Velocity incurred transaction costs of \$1.4 million related to the Ravin

acquisition, which were recorded as selling, general and administrative costs in the accompanying statement of operations as of December 31, 2018. The purchase price allocation was finalized during the first quarter of 2019.

Note C — Discontinued Operations

Sale of Manitoba Harvest

On February 19, 2019, the Company, as majority shareholder of Manitoba Harvest and as Shareholder Representative, entered into a definitive agreement (the "Arrangement Agreement") with Tilray, Inc. ("Tilray"), the other shareholders of Manitoba Harvest and a wholly-owned subsidiary of Tilray, 1197879 B.C. Ltd. ("Tilray Subco"), to sell to Tilray, Inc., through Tilray Subco, all of the issued and outstanding securities of Manitoba Harvest.

On February 28, 2019, Tilray Subco completed the acquisition of all the issued and outstanding securities of Manitoba Harvest pursuant to the Arrangement Agreement. Subject to certain customary adjustments, the shareholders of Manitoba Harvest, including the Company, received or will receive the following from Tilray as consideration for their shares of Manitoba Harvest: (i) C\$150 million in cash to the holders of preferred shares of Manitoba Harvest and the holders of common shares of Manitoba Harvest ("Common Holders") and C\$127.5 million in shares of class 2 Common Stock of Tilray ("Tilray Common Stock") to the Common Holders on the closing date of the sale (the "Closing Date Consideration"), and (ii) C\$50 million in cash and C\$42.5 million in Tilray Common Stock to the Common Holders on the date that is six months after the closing date of the arrangement (the "Deferred Consideration"). The sale consideration also includes a potential earnout of up to C\$49 million in Tilray Common Stock to the Common Holders, if Manitoba Harvest achieves certain levels of U.S. branded gross sales of edible or topical products containing broad spectrum hemp extracts or cannabidiols prior to December 31, 2019.

The cash portion of the Closing Date Consideration was reduced by the amount of the net indebtedness (including accrued interest) of Manitoba Harvest on the closing date of C\$71.3 million (\$53.7 million) and transaction expenses of approximately C\$5.0 million. The Company's share of the net proceeds after accounting for the redemption of the noncontrolling shareholders and the payment of net indebtedness of Manitoba Harvest and transaction expenses was approximately \$124.2 million in cash proceeds and in Tilray Common Stock. We recorded a receivable of \$48.0 million as of March 31, 2019 related to the Deferred Consideration portion of the proceeds. The Company recognized a gain on the sale of Manitoba Harvest of \$121.7 million in the three months ended March 31, 2019. No amount has been recorded related to the potential earnout as of March 31, 2019 based on an assessment of probability at the end of the quarter.

The Tilray Common Stock consideration was issued in reliance on the exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act") and pursuant to exemptions from applicable securities laws of any state of the United States, such that any shares of Tilray Common Stock received by the Common Holders were freely tradeable. The Company sold the Tilray Common Stock during March 2019, recognizing a net loss of \$5.3 million in Other income/ (expense) during the quarter ended March 31, 2019.

Summarized results of operations of Manitoba Harvest for the three months ended March 31, 2019 and 2018 through the date of disposition are as follows (in thousands):

	For the period January 1, 2019 through disposition	Three months ended March 31, 2018
Net revenues	\$ 10,024	\$ 16,341
Gross profit	4,874	6,945
Operating loss	(1,118)	(869)
Loss before income taxes	(1,127)	(880)
Provision (benefit) for income taxes	(541)	(486)
Loss from discontinued operations ⁽¹⁾	\$ (586)	\$ (394)

⁽¹⁾ The results of operations for the periods from January 1, 2019 through date of disposition and the three months ended March 31, 2018 exclude \$1.0 million and \$1.2 million, respectively, of intercompany interest expense.

The following table presents summary balance sheet information of the Manitoba Harvest business that is presented as discontinued operations as of December 31, 2018 (in thousands):

	December 31, 2018
Assets:	
Cash and cash equivalents	\$2,577
Accounts receivable, net	7,169
Inventories	11,436
Prepaid expenses and other current assets	773
Current assets of discontinued operations	\$21,955
Property, plant and equipment, net	18,157
Goodwill	37,777
Intangible assets, net	53,533
Non-current assets of discontinued operations	\$109,467
Liabilities:	
Accounts payable	4,259
Accrued expenses	4,313
Due to related party	350
Other current liabilities	507
Current liabilities of discontinued operations	\$9,429
Deferred income taxes	12,675
Other non-current liabilities	2,093
Non-current liabilities of discontinued operations	\$14,768
Noncontrolling interest of discontinued operations	\$11,160

Note D — 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.

Disaggregated Revenue - Revenue Streams and 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.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

The following tables provide disaggregation of revenue by reportable segment geography for the three months ended March 31, 2019 and 2018 (in thousands):

Three months ended March 31, 2019										
	5.11	Ergo	Liberty	Velocity	ACI	Arnold	Clean Earth	Foam	Sterno	Total
United States	\$70,477	\$7,335	\$21,736	\$26,164	\$23,069	\$17,916	\$63,632	\$26,137	\$85,134	\$341,600
Canada	1,664	819	468	1,477	—	179	—	—	5,032	9,639
Europe	7,282	6,531	—	2,201	—	9,770	—	—	683	26,467
Asia Pacific	3,414	7,306	—	229	—	1,260	—	—	290	12,499
Other international	5,252	461	—	1,066	—	903	—	4,545	57	12,284
	\$88,089	\$22,452	\$22,204	\$31,137	\$23,069	\$30,028	\$63,632	\$30,682	\$91,196	\$402,489
Three months ended March 31, 2018										
	5.11	Ergo	Liberty	Velocity	ACI	Arnold	Clean Earth	Foam	Sterno	Total
United States	\$64,452	\$8,203	\$22,757	\$20,085	\$22,063	\$17,282	\$58,221	13,486	\$60,259	\$286,808
Canada	2,017	765	697	1,353	—	368	—	—	3,941	9,141
Europe	8,558	7,158	—	1,508	—	10,146	—	—	840	28,210
Asia Pacific	4,241	5,692	—	330	—	911	—	—	163	11,337
Other international	4,689	344	—	1,131	—	692	—	1,971	29	8,856
	\$83,957	\$22,162	\$23,454	\$24,407	\$22,063	\$29,399	\$58,221	\$15,457	\$65,232	\$344,352

Note E — Operating Segment Data

At March 31, 2019, the Company had nine 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.

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 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 utilities, infrastructure, chemicals, aerospace and defense, non-public/ private development, medical, industrial and dredging. Clean Earth is headquartered in Hatboro, Pennsylvania.

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 March 31,	
	2019	2018
5.11 Tactical	\$88,089	\$83,957
Ergobaby	22,452	22,162
Liberty	22,204	23,454
Velocity Outdoor	31,137	24,407
ACI	23,069	22,063
Arnold	30,028	29,399
Clean Earth	63,632	58,221
Foam Fabricators	30,682	15,457
Sterno	91,196	65,232
Total segment revenue	402,489	344,352
Corporate and other	—	—
Total consolidated revenues	\$402,489	\$344,352

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Segment profit (loss) ⁽¹⁾ (in thousands)	Three months ended March 31,	
	2019	2018
5.11 Tactical	\$2,338	\$(617)
Ergobaby	3,136	2,340
Liberty	1,415	2,815
Velocity Outdoor	341	273
ACI	6,481	5,932
Arnold	1,477	1,725
Clean Earth	1,256	759
Foam Fabricators	3,506	725
Sterno	7,982	4,751
Total	27,932	18,703
Reconciliation of segment profit (loss) to consolidated income (loss) before income taxes:		
Interest expense, net	(18,582)	(6,182)
Other income (expense), net	(5,871)	(1,374)
Corporate and other ⁽²⁾	(13,991)	(14,234)
Total consolidated income (loss) before income taxes	\$(10,512)	\$(3,087)

(1) Segment profit (loss) represents operating income (loss).

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

Depreciation and Amortization Expense (in thousands)	Three months ended March 31,	
	2019	2018
5.11 Tactical	\$5,157	\$5,372
Ergobaby	2,111	2,042
Liberty	407	343
Velocity Outdoor	3,251	1,991
ACI	669	804
Arnold	1,622	1,516
Clean Earth	6,035	5,460
Foam Fabricators	2,997	885
Sterno	5,372	2,899
Total	27,621	21,312
Reconciliation of segment to consolidated total:		
Amortization of debt issuance costs and original issue discount	1,079	1,353
Consolidated total	\$28,700	\$22,665

Edgar Filing: Compass Diversified Holdings - Form 10-Q

	Accounts Receivable		Identifiable Assets	
	March 31, 2019	December 31, 2018	March 31, 2019 ⁽¹⁾	December 31, 2018 ⁽¹⁾
(in thousands)				
5.11 Tactical	\$53,161	\$52,069	\$349,336	\$319,583
Ergobaby	13,914	11,361	101,686	100,679
Liberty	11,937	10,416	36,871	27,881
Velocity Outdoor	20,025	21,881	208,809	209,398
ACI	8,394	9,193	18,493	13,407
Arnold	18,393	16,298	78,319	66,744
Clean Earth	58,558	60,317	222,773	204,316
Foam Fabricators	24,024	23,848	166,255	155,504
Sterno	68,286	72,361	259,332	253,637
Allowance for doubtful accounts	(13,198)	(12,510)	—	—
Total	263,494	265,234	1,441,874	1,351,149
Reconciliation of segment to consolidated total:				
Corporate and other identifiable assets	—	—	52,375	8,357
Assets of discontinued operations	—	—	—	131,702
Total	\$263,494	\$265,234	\$1,494,249	\$1,491,208

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

Note F — Property, Plant and Equipment and Inventory

Property, plant and equipment

Property, plant and equipment is comprised of the following at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019	December 31, 2018
Machinery and equipment	\$238,754	\$234,083
Furniture, fixtures and other	35,650	34,149
Leasehold improvements	34,873	35,458
Buildings and land	41,945	39,973
Construction in process	8,828	11,189
	360,050	354,852
Less: accumulated depreciation	(156,501)	(146,191)
Total	\$203,549	\$208,661

Depreciation expense was \$10.6 million and \$9.1 million and for the three months ended March 31, 2019 and March 31, 2018, respectively.

Inventory

Inventory is comprised of the following at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019	December 31, 2018
Raw materials	\$60,694	\$60,788
Work-in-process	14,297	12,915
Finished goods	260,028	253,982
Less: obsolescence reserve	(21,109)	(20,248)
Total	\$313,910	\$307,437

Note G — 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

2019 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. All of the Company's reporting units except Liberty were tested qualitatively at March 31, 2019. We determined that the Liberty reporting unit 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. We expect to conclude the goodwill impairment testing during the quarter ended June 30, 2019. For the reporting units that were tested qualitatively for the 2019 annual impairment testing, the results of the qualitative analysis indicated that it is more likely than not that the fair value exceeded their carrying value.

2018 Annual 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%.

22

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 quantitative impairment testing indicated that the fair value of the Arnold reporting unit exceeded the carrying value. A summary of the net carrying value of goodwill at March 31, 2019 and December 31, 2018, is as follows (in thousands):

	Three months ended March 31, 2019	Year ended December 31, 2018
Goodwill - gross carrying amount	\$643,036	\$647,046
Accumulated impairment losses	(31,153)	(31,153)
Goodwill - net carrying amount	\$611,883	\$615,893

The following is a reconciliation of the change in the carrying value of goodwill for the three months ended March 31, 2019 by operating segment (in thousands):

	Balance at January 1, 2019	Acquisitions ⁽¹⁾	Goodwill Impairment	Other	Balance at March 31, 2019
5.11	\$92,966	\$ —	\$ —	—\$ —	—\$92,966
Ergobaby	61,031	—	—	—	61,031
Liberty	32,828	—	—	—	32,828
Velocity Outdoor	62,675	284	—	—	62,959
ACI	58,019	—	—	—	58,019
Arnold ⁽²⁾	26,903	—	—	—	26,903
Clean Earth	144,778	(4,294)	—	—	140,484
Foam Fabricators	72,708	—	—	—	72,708
Sterno	55,336	—	—	—	55,336
Corporate ⁽³⁾	8,649	—	—	—	8,649
Total	\$615,893	\$ (4,010)	\$ —	—\$ —	—\$611,883

(1) Clean Earth's acquisition of DART and Velocity's acquisition of Ravin were finalized during the first quarter of 2019.

(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 indefinite lived intangible asset in connection with the annual impairment testing for 2019 and 2018. Results of the qualitative analysis indicate that it is more likely than not that the fair value of the reporting units that maintain indefinite lived intangible assets exceeded the carrying value.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Other intangible assets are comprised of the following at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Customer relationships	\$500,358	\$(139,413)	\$360,945	\$500,358	\$(130,157)	\$370,201
Technology and patents	79,707	(24,772)	54,935	79,646	(23,409)	56,237
Trade names, subject to amortization	208,161	(40,808)	167,353	208,074	(36,912)	171,162
Licensing and non-compete agreements	8,205	(7,104)	1,101	8,205	(6,972)	1,233
Permits and airspace	132,409	(43,769)	88,640	127,146	(41,291)	85,855
Distributor relations and other	726	(726)	—	726	(726)	—
Total	929,566	(256,592)	672,974	924,155	(239,467)	684,688
Trade names, not subject to amortization	60,373	—	60,373	60,433	—	60,433
Total intangibles, net	\$989,939	\$(256,592)	\$733,347	\$984,588	\$(239,467)	\$745,121

Amortization expense related to intangible assets was \$17.0 million and \$11.5 million for the three months ended March 31, 2019 and 2018, respectively. Estimated charges to amortization expense of intangible assets for the remainder of 2019 and the next four years, is as follows (in thousands):

	2019	2020	2021	2022	2023
	\$54,121	\$67,560	\$66,990	\$65,451	\$65,062

Note H — 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 three months ended March 31, 2019 and the year ended December 31, 2018 is as follows (in thousands):

	Three months ended March 31, 2019	Year ended December 31, 2018
Warranty liability:		
Beginning balance	\$1,624	\$2,197
Provision for warranties issued during the period	676	3,531
Fulfillment of warranty obligations	(836)	(4,258)
Other ⁽¹⁾	—	154
Ending balance	\$1,464	\$1,624

⁽¹⁾ 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 I — 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, 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 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 above.

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.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

The following table provides the Company's debt holdings at March 31, 2019 and December 31, 2018 (in thousands):

	March 31, December	
	2019	31, 2018
Senior Notes	400,000	400,000
Revolving Credit Facility	\$85,000	\$228,000
Term Loan	495,000	496,250
Less: unamortized discounts and debt issuance costs	(19,605)	(20,379)
Total debt	\$960,395	\$1,103,871
Less: Current portion, term loan facilities	(5,000)	(5,000)
Long term debt	\$955,395	\$1,098,871

Net availability under the 2018 Revolving Credit Facility was approximately \$514.8 million at March 31, 2019.

Letters of credit outstanding at March 31, 2019 totaled approximately \$0.3 million. At March 31, 2019, the Company was in compliance with all covenants as defined in the 2018 Credit Facility.

At March 31, 2019, the carrying value of the principal under the Company's outstanding Term Loan, including the current portion, was \$495.0 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	March 31, 2019 Carrying Value	Fair Value
Senior Notes	May 1, 2026	8.000 %	2	400,000	419,000

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 \$4.9 million and \$5.3 million at March 31, 2019 and December 31, 2018, 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 March 31, 2019 and December 31, 2018, the Swap had a fair value loss of \$3.1 million and \$2.1 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 March 31, 2019 and December 31, 2018 (in thousands):

	March 31, December	
	2019	31, 2018
Other current liabilities	\$ 1,041	\$ 582
Other noncurrent liabilities	2,036	1,490

Total fair value \$ 3,077 \$ 2,072

26

Note J — 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.

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 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 may be redeemed at the Company's option, in whole or in part, at any time after July 30, 2022, at a price of \$25.00 per share, plus any declared and unpaid distributions. Holders of Series A Preferred Shares will have no right to require the redemption of the Series A Preferred Shares and there is no maturity date. 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.

Sale Event

The sale of Manitoba Harvest in February 2019 qualified as a Sale Event under the Company's LLC Agreement. During the second quarter of 2019, the Company declared a distribution to the Allocation Member of \$7.7 million which will be paid in the second quarter of 2019. The profit allocation distribution was calculated based on the portion of the gain on sale related to the Closing Date Consideration, less the loss on sale of shares that were received as part of the Closing Consideration. An additional profit allocation distribution related to the Sale Event of Manitoba Harvest will be declared subsequent to receipt of the Deferred Consideration in August 2019.

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 March 31,	
	2019	2018
Net loss from continuing operations attributable to Holdings	\$(12,215)	\$(1,586)
Less: Distributions paid - Preferred Shares	3,781	1,813
Less: Accrued distributions - Preferred Shares	1,334	—
Net loss from continuing operations attributable to common shares of Holdings	\$(17,330)	\$(3,399)

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 months ended March 31, 2019 and 2018 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 months ended March 31, 2019 and 2018 attributable to the common shares of Holdings is calculated as follows (in thousands, except per share data):

	Three months ended March 31,	
	2019	2018
Loss from continuing operations attributable to common shares of Holdings	\$ (17,330)	\$ (3,399)
Less: Effect of contribution based profit - Holding Event	981	1,400
Loss from continuing operations attributable to common shares of Holdings	\$ (18,311)	\$ (4,799)
Income (loss) from discontinued operations attributable to common shares of	\$ 121,523	\$ (755)

Holdings

Basic and diluted weighted average common shares outstanding	59,900		59,900	
Basic and fully diluted income (loss) per common share attributable to Holdings				
Continuing operations	\$	(0.31)	\$ (0.08)
Discontinued operations	2.03		(0.01)
	\$	1.72		\$ (0.09)

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Distributions

The following table summarizes information related to our quarterly cash distributions on our Trust common and preferred shares (in thousands, except per share data):

Period	Cash Distribution per Share	Total Cash Distributions	Record Date	Payment Date
Trust Common Shares:				
January 1, 2019 - March 31, 2019 ⁽¹⁾	\$0.36	\$ 21,564	April 18, 2019	April 25, 2019
October 1, 2018 - December 31, 2018	\$0.36	\$ 21,564	January 17, 2019	January 24, 2019
July 1, 2018 - September 30, 2018	\$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
Series A Preferred Shares:				
January 30, 2019 - April 29, 2019 ⁽¹⁾	\$0.453125	\$ 1,813	April 15, 2019	April 30, 2019
October 30, 2018 - January 29, 2019	\$0.453125	\$ 1,813	January 15, 2019	January 30, 2019
July 30, 2018 - October 29, 2018	\$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
Series B Preferred Shares:				
January 30, 2019 - April 29, 2019 ⁽¹⁾	\$0.4921875	\$ 1,969	April 15, 2019	April 30, 2019
October 30, 2018 - January 29, 2019	\$0.4921875	\$ 1,969	January 15, 2019	January 30, 2019
July 30, 2018 - October 29, 2018	\$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

⁽¹⁾ This distribution was declared on April 4, 2019.

Note K — 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 March 31, 2019 and December 31, 2018:

	% Ownership ⁽¹⁾ March 31, 2019		% Ownership ⁽¹⁾ December 31, 2018	
	Primary	Fully Diluted	Primary	Fully Diluted
	5.11 Tactical	97.5	89.1	97.5
Ergobaby	81.9	75.4	81.9	76.4
Liberty	88.6	85.2	88.6	85.2
Velocity Outdoor	99.2	92.0	99.2	91.0
ACI	69.4	69.1	69.4	69.2
Arnold	96.7	80.2	96.7	79.4
Clean Earth	97.5	79.8	97.5	79.8
Foam Fabricators	100.0	91.5	100.0	91.5
Sterno	100.0	88.5	100.0	88.9

Edgar Filing: Compass Diversified Holdings - Form 10-Q

- (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	
	March 31, 2019	December 31, 2018
5.11 Tactical	\$10,386	\$9,873
Ergobaby	25,861	25,362
Liberty	3,369	3,342
Velocity Outdoor	2,740	2,524
ACI	(98)	(1,236)
Arnold	1,166	1,176
Clean Earth	9,208	8,888
Foam Fabricators	1,102	848
Sterno	(1,647)	(2,067)
Allocation Interests	100	100
	\$52,187	\$48,810

Note L — Fair Value Measurement

The following table provides the assets and liabilities carried at fair value measured on a recurring basis at March 31, 2019 and December 31, 2018 (in thousands):

	Fair Value Measurements at March 31, 2019			
	Carrying Value	Level 1	Level 2	Level 3
Liabilities:				
Put option of noncontrolling shareholders ⁽¹⁾	\$(173)	\$ —		\$(173)
Contingent consideration - acquisition ⁽²⁾	(4,374)	—		(4,374)
Interest rate swap	(3,077)	—	(3,077)	—
Total recorded at fair value	\$(7,624)	\$ —	—\$(3,077)	\$(4,547)

- (1) Represents put option issued to noncontrolling shareholders in connection with the 5.11 Tactical and Liberty acquisitions.
- (2) Represents potential earn-out payable as additional purchase price consideration by Velocity Outdoor in connection with the acquisition of Ravin.

	Fair Value Measurements at December 31, 2018			
	Carrying Value	Level 1	Level 2	Level 3
Liabilities:				
Put option of noncontrolling shareholders ⁽¹⁾	\$(173)	—		\$(173)
Contingent consideration - acquisition ⁽²⁾	(4,374)	—		(4,374)
Interest rate swap	(2,072)	—	(2,072)	—
Total recorded at fair value	\$(6,619)	\$ —	—\$(2,072)	\$(4,547)

- (1) Represents put option issued to noncontrolling shareholders in connection with the 5.11 Tactical and Liberty acquisitions.
- (2) Represents potential earn-out payable as additional purchase price consideration by Velocity Outdoor in connection with the acquisition of Ravin.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Reconciliations of the change in the carrying value of the Level 3 fair value measurements from January 1, 2018 through March 31, 2019 are as follows (in thousands):

	Level 3
Balance at January 1, 2018	\$(178)
Contingent consideration - Rimports ⁽¹⁾	(4,800)
Contingent consideration - Ravin ⁽²⁾	(4,734)
Decrease in the fair value of put option of noncontrolling shareholder - 5.11	5
Adjustment to Ravin contingent consideration	360
Reversal of contingent consideration - Rimports	4,800
Balance at January 1, 2019	\$(4,547)
Balance at March 31, 2019	\$(4,547)

⁽¹⁾ 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 estimated at \$4.8 million at acquisition date and was calculated as the present value of a probability adjusted earnout payment based on the expected term of the payment and a risk-adjusted discount rate. At December 31, 2018, the Company determined that the probability of achieving the earn-out was zero and therefore reversed the amount that was recorded as part of the purchase consideration.

⁽²⁾ 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 estimated at \$4.7 million at acquisition date and was calculated using a risk-adjusted option pricing model. The earnout was adjusted to \$4.3 million at December 31, 2018 based on actual results to date. The earn-out is expected to be paid in the second quarter of 2019.

Valuation Techniques

2018 Term Loan

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 March 31, 2019, the carrying value of the principal under the Company's outstanding 2018 Term Loan, including the current portion, was \$495.0 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, 2018.

Nonrecurring Fair Value Measurements

There were no assets carried at fair value on a non-recurring basis at March 31, 2019 and December 31, 2018, respectively.

Note M — 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.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

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 three months ended March 31, 2019 and 2018 is as follows:

	Three months ended March 31,	
	2019	2018
United States Federal Statutory Rate	(21.0)%	(21.0)%
State income taxes (net of Federal benefits)	0.7	(11.3)
Foreign income taxes	(3.6)	(3.2)
Expenses of Compass Group Diversified Holdings LLC representing a pass through to shareholders ⁽¹⁾	24.0	(1.0)
Impact of subsidiary employee stock options	0.6	(24.2)
Credit utilization	(0.9)	(7.0)
Non-recognition of NOL carryforwards at subsidiaries	1.1	8.6
Effect of Tax Act	3.5	(2.9)
Other	(0.5)	1.7
Effective income tax rate	3.9 %	(60.3)%

⁽¹⁾ The effective income tax rate for the three months ended March 31, 2019 and 2018 includes a loss at the Company's parent, which is taxed as a partnership.

Note N — 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 \$3.9 million is recognized in the consolidated balance sheet as a component of other non-current liabilities at March 31, 2019. Net periodic benefit cost consists of the following for the three months ended March 31, 2019 and 2018 (in thousands):

	Three months ended March 31,	
	2019	2018
Service cost	\$127	\$137
Interest cost	33	25
Expected return on plan assets	(40)	(40)
Amortization of unrecognized loss	34	50
Net periodic benefit cost	\$154	\$172

During the three months ended March 31, 2019, per the terms of the pension agreement, Arnold contributed \$0.1 million to the plan. For the remainder of 2019, the expected contribution to the plan will be approximately \$0.7 million.

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 March 31, 2019 were considered Level 3.

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.

Leases

The Company and its subsidiaries lease manufacturing facilities, warehouses, office facilities, retail stores, equipment and vehicles under various operating arrangements. Certain of the leases are subject to escalation clauses and renewal periods. The Company and its subsidiaries recognize lease expense, including predetermined fixed escalations, on a straight-line basis over the initial term of the lease including reasonably assured renewal periods from the time that the Company and its subsidiaries control the leased property. Leases with an initial term of 12 months or less are not recorded on the balance sheet; we recognize lease expense for these leases on a straight-line basis over the lease term. Certain of our subsidiaries have leases that contain both fixed rent costs and variable rent costs based on achievement of certain operating metrics. The variable lease expense has not been material on a historic basis and no amount was incurred during the quarter ending March 31, 2019.

The cost components of our operating leases were as follows (in thousands):

	Three Months Ended March 31, 2019
Operating lease cost ⁽¹⁾	\$ 7,637
Total	\$ 7,637

⁽¹⁾ Includes short-term leases, which are immaterial.

The maturities of lease liabilities at March 31, 2019 were as follows (in thousands):

2019 (excluding three months ended March 31, 2019)	\$ 20,530
2020	26,163
2021	22,793
2022	19,133
2023	13,087
Thereafter	44,432
Total undiscounted lease payments	\$ 146,138
Less: Interest	35,863
Present value of lease liabilities	\$ 110,275

The calculated amount of the ROU assets and lease liabilities in the table above are impacted by the length of the lease term and discount rate used to present value the minimum lease payments. The Company's lease agreements often include one or more options to renew at the company's discretion. If at lease inception, the Company considers the exercising of a renewal option to be reasonable certain. Regarding the discount rate, Topic 842 requires the use of a rate implicit in the lease whenever this rate is readily determinable. As this rate is rarely determinable, the Company utilizes the incremental borrowing rate of the subsidiary entering into the lease arrangement, on a collateralized basis, over a similar term as adjusted for any country specific risk. For operating leases existing prior to January 1, 2019, the rate for the remaining lease term as of January 1, 2019 was used.

The weighted average remaining lease terms and discount rates for all of our operating leases were as follows as of March 31, 2019:

Lease Term and Discount Rate	
Weighted-average remaining lease term (years)	
Operating leases	6.56
Weighted-average discount rate	
Operating leases	7.74%

Supplemental cash flow information related to leases was as follows (in thousands):

	Three months ended March 31, 2019
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	\$ 7,637
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	\$ 417

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 a total of \$1.5 million in integration services fees, with \$0.75 million paid in 2018. Foam Fabricators paid CGM \$2.25 million over the term of the ISA, \$2.0 million in 2018 and \$0.3 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 \$56.8 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 months ended March 31, 2019, 5.11 purchased approximately \$1.3 million 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, 2018 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 nine businesses, or operating segments, at March 31, 2019. 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"), 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 March 31, 2019 as follows:

Business	Acquisition Date	Ownership	
		Primary	Diluted
		Interest - March 31, 2019	
Advanced Circuits	May 16, 2006	69.4%	69.1%
Liberty Safe	March 31, 2010	88.6%	85.2%
Ergobaby	September 16, 2010	81.9%	75.4%
Arnold	March 5, 2012	96.7%	80.2%
Clean Earth	August 7, 2014	97.5%	79.8%
Sterno	October 10, 2014	100.0%	88.5%
5.11 Tactical	August 31, 2016	97.5%	89.1%
Velocity Outdoor	June 2, 2017	99.2%	92.0%
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.

Ergobaby - Headquartered in Los Angeles, California, Ergobaby is dedicated to building a global community of confident parents with smart, ergonomic solutions that enable and encourage bonding between parents and babies.

Ergobaby

35

offers a broad range of award-winning baby carriers, strollers, car seats, swaddlers, nursing pillows, and related products that fit into families' daily lives seamlessly, comfortably and safely. 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.

Velocity Outdoor - 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. 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" or "Ravin Crossbows"), 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. Velocity Outdoor is headquartered in Bloomfield, New York.

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 50% - 55% 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 serves a variety of markets including aerospace and defense, motorsport/ automotive, oil and gas, medical, general industrial, energy, reprographics and advertising specialties. Over the course of 100+ years, Arnold has successfully evolved and adapted our products, technologies, and manufacturing presence to meet the demands of current and emerging 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. Arnold has expanded globally and built strong relationships with our customers worldwide. Arnold is the largest and, we believe, the most technically advanced U.S. manufacturer of engineered magnetic systems. Arnold is headquartered in Rochester, New York.

Clean Earth - Headquartered in Hatboro, Pennsylvania, 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 utilities, infrastructure, chemicals, aerospace and defense, non-public/ private development, medical, industrial and dredging.

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 - The Sterno Group LLC ("Sterno"), headquartered in Corona, California, is the parent company of Sterno Products, LLC ("Sterno Products"), Sterno Home Inc. ("Sterno Home"), and Rimports, LLC. Sterno is a leading manufacturer and marketer of portable food warming fuels for the hospitality and consumer markets, flameless

candles and house and garden lighting for the home decor market, and wickless candle products used for home decor and fragrance systems. We made loans to, and purchased all of the equity interests in, Sterno on October 10, 2014 for approximately \$160.0 million. 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, Inc. ("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. The middle market continues to be an active segment for deal flow, with further acceleration of deal flow expected in 2019. High valuation levels continue to be driven by the availability of debt capital with favorable terms and financial and strategic buyers seeking to deploy available equity capital. We believe that companies will focus on expanding their customer bases by diversifying their products and services in existing geographic areas during 2019.

Recent Events

Sale of Manitoba Harvest

On February 19, 2019, we entered into a definitive agreement with Tilray, Inc. ("Tilray") and a wholly-owned subsidiary of Tilray, 1197879 B.C. Ltd. ("Tilray Subco"), to sell to Tilray, through Tilray Subco, all of the issued and outstanding securities of our majority owned subsidiary, Manitoba Harvest for total consideration of up to C\$419 million. The completion of the sale of Manitoba Harvest was subject to approval by the British Columbia Supreme Court, which occurred on February 21, 2019. The sale closed on February 28, 2019. Subject to certain customary adjustments, the shareholders of Manitoba Harvest, including the Company, received or will receive the following from Tilray as consideration for their shares of Manitoba Harvest: (i) C\$150 million in cash to the holders of preferred shares of Manitoba Harvest and the holders of common shares of Manitoba Harvest ("Common Holders") and C\$127.5 million in shares of class 2 Common Stock of Tilray ("Tilray Common Stock") to the Common Holders on the closing date of the sale (the "Closing Date Consideration"), and (ii) C\$50 million in cash and C\$42.5 million in Common Stock to the Common Holders on the date that is six months after the closing date of the arrangement (the "Deferred Consideration"). The sale consideration also includes a potential earnout of up to C\$49 million in Tilray Common Stock to the Common Holders, if Manitoba Harvest achieves certain levels of U.S. branded gross sales of edible or topical products containing broad spectrum hemp extracts or cannabidiols prior to December 31, 2019.

The cash portion of the Closing Date Consideration was reduced by the amount of the net indebtedness (including accrued interest) of Manitoba Harvest on the closing date of C\$71.3 million (\$53.7 million) and transaction expenses of approximately C\$5.0 million. We recognized a gain on the sale of Manitoba Harvest of \$121.7 million in the first quarter of 2019. Refer to "Liquidity and Capital Resources, Profit Allocation Payments" for a discussion of the profit allocation associated with the sale of Manitoba Harvest. Our share of the net proceeds after accounting for the redemption of the noncontrolling shareholders and the payment of net indebtedness of Manitoba Harvest and transaction expenses was approximately \$124.2 million in cash proceeds and in Tilray Common Stock. We recorded a

receivable of \$48.0 million as of March 31, 2019 related to the Deferred Consideration portion of the proceeds. No

37

amount has been recorded related to the potential earnout as of March 31, 2019 based on an assessment of probability at the end of the quarter.

The Tilray Common Stock consideration was issued in reliance on the exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act") and pursuant to exemptions from applicable securities laws of any state of the United States, such that any shares of Common Stock received by the Common Holders were freely tradeable. We sold the Tilray Common Stock during March 2019, recognizing a net loss of \$5.3 million in Other income (expense) during the quarter ended March 31, 2019.

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.

Results of Operations

The following discussion reflects a comparison of the historical results of operations of our consolidated business for the three months ended March 31, 2019 and March 31, 2018, 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, 2018. The historical operating results of Rimports prior to acquisition by Sterno on February 26, 2018 have been added to the results of operations of Sterno for the three months ended March 31, 2018 for comparability purposes. 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 March 31, 2019 compared to three months ended March 31, 2018

Results of Operations - Consolidated

The following table sets forth our unaudited results of operations for the three months ended March 31, 2019 and 2018:

	Three months ended	
	March 31, 2019	March 31, 2018
Net revenues	\$402,489	\$344,352
Cost of revenues	266,300	225,186
Gross profit	136,189	119,166
Selling, general and administrative expense	93,199	91,300
Fees to manager	11,082	10,762
Amortization of intangibles	17,040	11,537
Operating income	14,868	5,567
Interest expense	(18,582)	(6,182)
Amortization of debt issuance costs	(927)	(1,098)
Other income (expense)	(5,871)	(1,374)
Loss from continuing operations before income taxes	(10,512)	(3,087)
Provision (benefit) for income taxes	403	(1,860)
Loss from continuing operations	\$(10,915)	\$(1,227)

Net revenues

On a consolidated basis, net revenues for the three months ended March 31, 2019 increased by approximately \$58.1 million, or 16.9%, compared to the corresponding period in 2018. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$15.3 million and \$32.4 million, respectively, to the increase in net revenues. During the three months ended March 31, 2019 compared to 2018, we also saw notable revenue increases at Clean Earth (\$5.4 million increase primarily due to add-on acquisitions in the prior year), 5.11 (\$4.1 million increase), and Velocity Outdoor (\$6.7 million increase related to the Ravin acquisition), partially offset by a decrease in sales at our Liberty business (\$1.2 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 \$41.1 million during the three-month period ended March 31, 2019 compared to the corresponding period in 2018. Our acquisitions of Foam Fabricators and Rimports in February 2018 contributed \$10.3 million and \$24.9 million, respectively, to the increase. Clean Earth's cost of revenue increased \$4.1 million due to the prior year acquisitions, and Velocity's cost of sales increased \$4.5 million as a result of the Ravin acquisition. Gross profit as a percentage of net revenues was approximately 33.8% in the three months ended March 31, 2019 compared to 34.6% in the three months ended March 31, 2018. 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 \$1.9 million during the three-month period ended March 31, 2019, compared to the corresponding period in 2018. 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 \$3.3 million in the first quarter of 2019 and \$3.6 million in the first quarter of 2018.

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 March 31, 2019, we incurred approximately \$11.1 million in management fees as compared to \$10.8 million in fees in the three months ended March 31, 2018. The increase was attributable to add-on acquisitions at Clean Earth and the Ravin acquisition by Velocity in the second and third quarter of 2018, offset by the sale of Manitoba Harvest in the first quarter of 2019.

Amortization expense

Amortization expense for the three months ended March 31, 2019 increased \$5.5 million as compared to the three months ended March 31, 2018 primarily as a result of the acquisition of Foam Fabricators and Rimports in February 2018, and add-on acquisitions at Clean Earth and Velocity in 2018.

Interest Expense

We recorded interest expense totaling \$18.6 million for the three months ended March 31, 2019 compared to \$6.2 million for the comparable period in 2018, an increase of \$12.4 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 average amount outstanding under our revolving credit facility in the first quarter of 2019 as compared to the first quarter of 2018.

Other income (expense)

For the quarter ended March 31, 2019, we recorded \$5.9 million in other expense as compared to \$1.4 million in other expense in the quarter ended March 31, 2018, an increase in expense of \$4.5 million. In the current quarter, we incurred \$5.3 million in loss on the sale of the Tilray Common Stock we received related to the sale of Manitoba Harvest, and a loss of \$0.4 million related to foreign exchange losses on the repayment of the intercompany loans of Manitoba Harvest.

Income Taxes

We had an income tax provision of \$0.4 million with an effective income tax rate of (3.9%) from continuing operations during the three months ended March 31, 2019 compared to an income tax benefit of \$1.9 million with an effective income tax rate of 60.3% from continuing operations during the same period in 2018. While our earnings before taxes for the quarter ended March 31, 2019 decreased by approximately \$7.4 million as compared to the prior year quarter ended March 31, 2018, the effect of foreign taxes at our subsidiaries increased our current tax expense provision during the quarter.

Results of Operations - Business Segments

Branded Consumer Businesses

5.11 Tactical

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$88,089	100.0 %	\$83,957	100.0 %
Gross profit	\$42,945	48.8 %	\$38,551	45.9 %
SG&A	\$38,171	43.3 %	\$36,731	43.7 %
Operating income (loss)	\$2,338	2.7 %	\$(617)	(0.7)%

Net sales

Net sales for the three months ended March 31, 2019 were \$88.1 million as compared to net sales of \$84.0 million for the three months ended March 31, 2018, an increase of \$4.1 million, or 4.9%. This increase is due primarily to retail and e-commerce sales growth of \$5.8 million or 29%, driven by growing demand in direct to consumer channels.

Retail sales grew largely due to thirteen new retail store openings since March 2018 (bringing the total store count to forty-five as of March 31, 2019). The increase in net sales for the three months ended March 31, 2019 as compared to the corresponding period in the prior year was offset by a \$3.9 million decline in professional sales. During the quarter ended March 31, 2018, 5.11 shipped a larger than usual amount of professional orders as they entered 2018 with a large backlog resulting from the implementation of a new enterprise resource planning (ERP) system in 2017 which affects the quarter over quarter comparison of professional sales.

Gross profit

Gross profit as a percentage of net sales was 48.8% in the three months ended March 31, 2019 as compared to 45.9% for the three months ended March 31, 2018. The prior period cost of sales included a higher level of chargebacks and discretionary discounts granted to customers as 5.11 worked through the backlog associated with challenges experienced while implementing the new ERP system.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended March 31, 2019 was \$38.2 million, or 43.3% of net sales compared to \$36.7 million, or 43.7% of net sales for the comparable period in 2018. The increase in selling, general and administrative expense is consistent with the increase in net sales in the current period.

Income (loss) from operations

Income from operations for the three months ended March 31, 2019 was \$2.3 million, an increase of \$3.0 million when compared to a loss from operations of \$0.6 million for the same period in 2018, based on the factors described above.

Ergobaby

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$22,452	100.0%	\$22,162	100.0%
Gross profit	\$14,218	63.3 %	\$14,939	67.4 %
SG&A	\$9,132	40.7 %	\$10,671	48.1 %
Operating income	\$3,136	14.0 %	\$2,340	10.6 %

Net sales

Net sales for the three months ended March 31, 2019 were \$22.5 million, an increase of \$0.3 million, or 1.3%, compared to the same period in 2018. During the three months ended March 31, 2019, international sales were approximately \$15.6 million, representing an increase of \$1.6 million over the corresponding period in 2018, primarily as a result of increased sales volume at Ergobaby's Asia-Pacific distributors. Domestic sales were \$6.9 million in the first quarter of 2019, reflecting a decrease of \$1.3 million compared to the corresponding period in 2018. The decrease in domestic sales was primarily the result of a decline in the Tula domestic business.

Gross profit

Gross profit as a percentage of net sales was 63.3% for the quarter ended March 31, 2019, as compared to 67.4% for the three months ended March 31, 2018. The decrease in gross profit was due to a shift in the sales mix from higher margin channels to lower margin channels quarter over quarter.

Selling, general and administrative expense

Selling, general and administrative expense decreased quarter over quarter, with expense of \$9.1 million, or 40.7% of net sales for the three months ended March 31, 2019 as compared to \$10.7 million or 48.1% of net sales for the same period of 2018. The decrease in selling, general and administrative expense as a percentage of net sales in the three months ended March 31, 2019 as compared to the comparable period in the prior year is due to expenses related to the bankruptcy of a large U.S. retail customer that were incurred in the first quarter of 2018, reduction in marketing spend, lower variable expenses related to sales, and a decrease in payroll expense during the current quarter.

Income from operations

Income from operations for the three months ended March 31, 2019 increased \$0.8 million, compared to the same period of 2018, based on the factors noted above.

Liberty Safe

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$22,204	100.0%	\$23,453	100.0%
Gross profit	\$4,421	19.9 %	\$6,249	26.6 %
SG&A	\$2,863	12.9 %	\$3,291	14.0 %
Operating income	\$1,415	6.4 %	\$2,815	12.0 %

Net sales

Net sales for the quarter ended March 31, 2019 decreased approximately \$1.2 million, or 5.3%, to \$22.2 million, compared to the corresponding quarter ended March 31, 2018. Non-Dealer sales were approximately \$7.7 million in the three months ended March 31, 2019 compared to \$9.0 million for the three months ended March 31, 2018, representing a decrease of \$1.3 million, or 14.4%. The decrease in Non-Dealer sales was primarily due to softer demand in the sporting goods channel. Dealer sales totaled approximately \$14.6 million in the three months ended March 31, 2019 compared to \$14.4 million in the same period in 2018, representing an increase of \$0.2 million or 1.4%.

Gross profit

Gross profit as a percentage of net sales totaled approximately 19.9% and 26.6% for the quarters ended March 31, 2019 and March 31, 2018, respectively. The decrease in gross profit as a percentage of net sales during the three months ended March 31, 2019 compared to the same period in 2018 is primarily attributable to cost increases in raw materials and manufacturing and overhead variances resulting from lower production levels in the first quarter of 2019. Liberty has continued to see a rise in raw material costs, particularly the cost of steel, during 2019 as the tariffs on imported steel has led to rising domestic steel prices. The tariffs began affecting steel costs in the second quarter of 2018, therefore the steel costs in the prior year do not yet reflect the effect of the tariffs on steel costs. 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 \$2.9 million for the three months ended March 31, 2019 compared to \$3.3 million for the three months ended March 31, 2018. The decrease in selling, general and administrative expense during the current quarter is primarily related to planned expense reductions and the timing of annual advertising spend. Selling, general and administrative expense represented 12.9% of net sales in the three months ended March 31, 2019 and 14.0% of net sales for the same period of 2018.

Income from operations

Income from operations decreased \$1.4 million during the three months ended March 31, 2019 to \$1.4 million, compared to the corresponding period in 2018. This decrease was primarily a result of the decrease in gross profit for the quarter, for the reasons noted above.

Velocity Outdoor

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$31,137	100.0%	\$24,407	100.0%
Gross profit	\$9,287	29.8 %	\$7,079	29.0 %
SG&A	\$6,543	21.0 %	\$5,471	22.4 %
Operating income	\$341	1.1 %	\$273	1.1 %

Net sales

Net sales for the three months ended March 31, 2019 were \$31.1 million, an increase of \$6.7 million or 27.6%, compared to the same period in 2018. The increase in net sales for the three months ended March 31, 2019 is primarily due to the add on acquisition of Ravin Crossbows, which had net sales of \$9.9 million in the quarter ended March 31, 2019, partially offset by sales associated with the Junior Reserve Officer Training Corps (JROTC) contract that shipped in the first quarter of 2018 along with general softness in the archery product line.

Gross profit

Gross profit as a percentage of net sales was 29.8% for the three months ended March 31, 2019 as compared to 29.0% in the three months ended March 31, 2018. The increase in gross profit of \$2.2 million was driven primarily by sales associated with the Ravin acquisition.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended March 31, 2019 was \$6.5 million, or 21.0% of net sales compared to \$5.5 million, or 22.4% of net sales for the three months ended March 31, 2018. The increase in selling, general and administrative expense for the three months ended March 31, 2019 is primarily related to the Ravin acquisition offset by the non-recurrence of the integration fee paid in 2018 to CGM.

Income from operations

Income from operations for the three months ended March 31, 2019 was \$0.34 million, an increase of \$0.07 million when compared to income from operations of \$0.27 million for the same period in 2018, based on the factors described above.

Niche Industrial Businesses

Advanced Circuits

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$23,069	100.0%	\$22,063	100.0%
Gross profit	\$10,604	46.0 %	\$10,026	45.4 %
SG&A	\$3,767	16.3 %	\$3,658	16.6 %
Operating income	\$6,481	28.1 %	\$5,932	26.9 %

Net sales

Net sales for the three months ended March 31, 2019 were \$23.1 million, an increase of approximately \$1.0 million or 4.6% compared to the three months ended March 31, 2018. The increase in net sales was due to increased sales in Quick-Turn Small-Run PCBs, Long-Lead Time PCBs, Subcontract PCBs, and a decrease in promotions, partially offset by decreased sales in Quick-Turn Production PCBs. Quick-Turn Small-Run PCBs comprised approximately 19.4% of gross sales and Quick-Turn Production PCBs represented approximately 31.8% of gross sales for the first quarter of 2019. Quick-Turn Small-Run PCBs comprised approximately 19.4% of gross sales and Quick-Turn Production PCBs represented approximately 34.3% of gross sales for the first quarter 2018.

Gross profit

Gross profit as a percentage of net sales increased 60 basis points during the three months ended March 31, 2019 compared to the corresponding period in 2018 (46.0% at March 31, 2019 compared to 45.4% at March 31, 2018) primarily as a result of sales mix.

Selling, general and administrative expense

Selling, general and administrative expense was approximately \$3.8 million in the three months ended March 31, 2019 compared to \$3.7 million in the three months ended March 31, 2018. Selling, general and administrative expense represented 16.3% of net sales for the three months ended March 31, 2019 compared to 16.6% of net sales in the corresponding period in 2018.

Income from operations

Income from operations for the three months ended March 31, 2019 was approximately \$6.5 million compared to \$5.9 million in the same period in 2018, an increase of approximately \$0.5 million, principally as a result of the factors described above.

Arnold

	Three months ended			
	March 31, 2019		March 31, 2018	
Net sales	\$30,028	100.0%	\$29,399	100.0%
Gross profit	\$7,239	24.1 %	\$7,710	26.2 %
SG&A	\$4,797	16.0 %	\$4,999	17.0 %
Operating income	\$1,477	4.9 %	\$1,725	5.9 %

Net sales

Net sales for the three months ended March 31, 2019 were approximately \$30.0 million, an increase of \$0.6 million compared to the same period in 2018. The increase in net sales is primarily a result of increased demand in the aerospace and defense markets. International sales were \$12.1 million in both the three months ended March 31, 2019 and March 31, 2018.

Gross profit

Gross profit for the three months ended March 31, 2019 was approximately \$7.2 million compared to approximately \$7.7 million in the same period of 2018. Gross profit as a percentage of net sales decreased from 26.2% for the quarter ended March 31, 2018 to 24.1% in the quarter ended March 31, 2019 principally due to unfavorable currency fluctuations.

Selling, general and administrative expense

Selling, general and administrative expense in the three month period ended March 31, 2019 was \$4.8 million, compared to approximately \$5.0 million for the three months ended March 31, 2018. Selling, general and administrative expense was 16.0% of net sales in the three months ended March 31, 2019 and 17.0% in the three months ended March 31, 2018.

Income from operations

Income from operations for the three-months ended March 31, 2019 was approximately \$1.5 million, a decrease of \$0.2 million when compared to the same period in 2018, as a result of the factors noted above.

Clean Earth

	Three months ended			
	March 31, 2019		March 31, 2018	
Net revenues	\$63,632	100.0%	\$58,221	100.0%
Gross profit	\$16,634	26.1 %	\$15,278	26.2 %
SG&A	\$11,802	18.5 %	\$11,137	19.1 %
Operating income	\$1,257	2.0 %	\$759	1.3 %

Net revenues

Net revenues for the three months ended March 31, 2019 were approximately \$63.6 million, an increase of \$5.4 million, or 9.3%, compared to the same period in 2018. The increase in net revenues is due to acquisitions made in the last year as well as improved performance in the hazardous waste base business. For the three months ended March 31, 2019, contaminated soil revenue increased 12% as compared to the same period last year, which is principally attributable to a recent acquisition. Hazardous waste revenues increased 32% principally as a result of recent acquisitions and growth in the base business. Net revenues from dredged material decreased \$4.9 million during the three months ended March 31, 2019 as compared to the same period in 2018 due to the timing of projects. Contaminated soils represented approximately 51% of net revenues for the three months ended March 31, 2019 and 50% of net revenues for the three months ended March 31, 2018.

Gross profit

Gross profit for the three months ended March 31, 2019 was approximately \$16.6 million compared to approximately \$15.3 million in the same period of 2018, with a majority of the increase in gross profit reflecting the increase in hazardous volume during the current period, recent acquisitions and improved processing efficiencies. Gross profit as a percentage of net revenues was consistent quarter over quarter at 26.2% for the three-month period ended March 31, 2018 compared to 26.1% for the same period ended March 31, 2019.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended March 31, 2019 increased to approximately \$11.8 million, or 18.5%, of net revenues, as compared to \$11.1 million, or 19.1%, of net revenues for the same period in 2018. The increased spending is related to the integration costs of recent acquisitions and increased labor expenses as a result of the acquisitions.

Income from operations

Income from operations for the three months ended March 31, 2019 was approximately \$1.3 million as compared to income from operations of \$0.8 million for the three months ended March 31, 2018, an increase of \$0.5 million, primarily as a result of those factors described above.

Foam Fabricators

	Three months ended			
	March 31, 2019		March 31, 2018	
	Pro forma			
Net sales	\$30,682	100.0%	\$30,490	100.0%
Gross profit	\$8,488	27.7 %	\$7,450	24.4 %
SG&A	\$2,736	8.9 %	\$4,418	14.5 %
Operating income	\$3,506	11.4 %	\$786	2.6 %

Pro forma financial information for Foam Fabricators for the three months ended March 31, 2018 includes pre-acquisition results of operations for the period from January 1, 2018 through February 15, 2018, the date of acquisition of Foam, for comparative purposes. The historical results of Foam Fabricators have been adjusted to reflect the purchase accounting adjustments recorded in connection with the acquisition: \$0.2 million in stock compensation 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 quarter ended March 31, 2019 were \$30.7 million, an increase of \$0.2 million, or 0.6%, compared to the quarter ended March 31, 2018. 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

Gross profit as a percentage of net sales was 27.7% and 24.4% for the three months ended March 31, 2019 and 2018, respectively. Cost of sales for the quarter ended March 31, 2018 includes \$0.7 million of expense related to the amortization of inventory step-up resulting from the purchase price allocation of Foam Fabricators. Excluding the effect of the inventory step-up, prior year gross profit as a percentage of net sales was 26.6%. The increase in gross profit as a percentage of net sales in the quarter ended March 31, 2019 was due to a price increase for contract customers effective April 1, 2018 and a price increase for non-contract customers in December 2018 to offset increases in the price of expanded polystyrene ("EPS") resin. A majority of Foam Fabricator's products are made with 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 March 31, 2019 was \$2.7 million as compared to \$4.4 million for the three months ended March 31, 2018, a decrease of \$1.7 million. Selling, general and administrative expense for the three months ended March 31, 2018 included \$1.5 million in transaction expenses related to the acquisition. Excluding the acquisition expenses, selling, general and administrative expense for the three months ended March 31, 2018 was \$2.9 million, which is consistent with the expenses incurred in the current period.

Income from operations

Income from operations was \$3.5 million for the three months ended March 31, 2019 as compared to \$0.8 million for the three months ended March 31, 2018, an increase of \$2.7 million, primarily as a result of the factors noted above.

Sterno

	Three months ended			
	March 31, 2019		March 31, 2018	
	Pro forma			
Net sales	\$91,195	100.0%	\$90,027	100.0%
Gross profit	\$22,354	24.5 %	\$22,231	24.7 %
SG&A	\$10,093	11.1 %	\$10,024	11.1 %
Operating income	\$7,982	8.8 %	\$8,589	9.5 %

Pro forma financial information for Sterno for the three months ended March 31, 2018 includes pre-acquisition results of operations for Rimports, which was acquired by Sterno on February 26, 2018, for the period from January 1, 2018 through the date of acquisition for

comparative purposes. The historical results of Rimports have been adjusted to reflect an additional \$1.6 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 March 31, 2019 were approximately \$91.2 million, an increase of \$1.2 million, or 1.3%, compared to the same period in 2018. The net sales variance reflects increased Rimports sales relating to wax, scent charms and room sprays products.

Gross profit

Gross profit as a percentage of net sales decreased from 24.7% for the three months ended March 31, 2018 to 24.5% for the same period ended March 31, 2019. The decrease in gross profit percentage as compared to the quarter ended March 31, 2018 primarily reflects sales mix, with more lower margin products sold in the current quarter versus the prior year.

Selling, general and administrative expense

Selling, general and administrative expense for the three months ended March 31, 2019 and 2018 was consistent quarter over quarter, at approximately \$10.1 million and \$10.0 million, respectively. The expense from the prior year quarter reflects \$0.6 million in acquisition expenses related to the acquisition of Rimports. Excluding the acquisition expenses, selling, general and administrative expense increased \$0.7 million, reflecting higher legal and audit fees. Selling, general and administrative expense represented 11.1% of net sales for both the three months ended March 31, 2019 and March 31, 2018.

Income from operations

Income from operations for the three months ended March 31, 2019 was approximately \$8.0 million, a decrease of \$0.6 million compared to the three months ended March 31, 2018 based on the factors noted above.

Liquidity and Capital Resources

Liquidity

At March 31, 2019, we had approximately \$39.8 million of cash and cash equivalents on hand, a decrease of \$10.9 million as compared to the year ended December 31, 2018. 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:

	Three months ended	
(in thousands)	March 31, 2019	March 31, 2018
Cash (used in) provided by operating activities	\$(8,936)	\$ 6,643

For the three months ended March 31, 2019, cash flows used in operating activities totaled approximately \$8.9 million, which represents a \$15.7 million decrease compared to cash provided by operating activities of \$6.6 million during the three-month period ended March 31, 2018. Cash used in operating activities for working capital for the three months ended March 31, 2019 was \$29.4 million, as compared to cash used in operating activities for working capital of \$10.5 million for the three months ended March 31, 2018. The increase in cash used for working capital purposes in the current quarter 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.

Investing Activities:

	Three months ended	
(in thousands)	March 31, 2019	March 31, 2018
Cash provided by (used in) investing activities	\$ 168,944	\$(415,628)

Cash flows provided by investing activities for the three months ended March 31, 2019 totaled approximately \$168.9 million, compared to cash used in investing activities of \$415.6 million in the same period of 2018. Cash flows from Manitoba Harvest, which is reflected as discontinued operations, totaled \$51.5 million in the current quarter and reflects the effect of the sale transaction. Cash provided by investing activities from continuing operations in the current year primarily relates to the proceeds received from the sale of Manitoba Harvest. In the prior year, we had a platform acquisition in the first quarter, Foam Fabricators, and several add on acquisitions at our subsidiaries, including the Sterno acquisition of Rimpports in February 2018. The total amount spent on acquisitions in the three months ended March 31, 2018 was approximately \$402.8 million. Capital expenditures in the three months ended March 31, 2019 decreased approximately \$4.6 million compared to the same period in the prior year, due primarily to larger than typical expenditures at our 5.11 and Arnold businesses in the prior year. We expect capital expenditures for the full year of 2019 to be approximately \$45 million to \$55 million.

Financing Activities:

(in thousands)	Three months ended	
	March 31, 2019	March 31, 2018
Cash (used in) provided by financing activities	\$(172,448)	\$413,418

Cash flows used in financing activities totaled approximately \$172.4 million during the three months ended March 31, 2019 compared to cash flows provided by financing activities of \$413.4 million during the three months ended March 31, 2018. The 2018 activity primarily related to the financing of our acquisitions of Foam Fabricators and Rimpports in February 2018, which were financed through draws on our 2014 Revolving Credit Facility, partially offset by net proceeds of \$96.7 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 the current quarter, we used proceeds from the sale of Manitoba Harvest to repay a portion of the outstanding amount on the 2018 Revolving Credit Facility, and paid our distributions on our common and preferred 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.

Due to significant capital expenditures related to the implementation of a new ERP system, warehouse expansion and retail roll out, we granted 5.11 waivers under their intercompany debt agreement effective as of the quarter ended September 30, 2017 through December 31, 2018. The waivers permitted 5.11 to increase its allowable capital expenditure limits and excluded certain capital expenditures associated with the ERP system and warehouse expansion from the calculation of the fixed charge coverage ratio. We further amended the 5.11 intercompany debt agreement during 2018 to allow for an additional \$5.0 million outstanding debt to be permitted under 5.11's Term B loan. In the first quarter of 2019, we further amended the 5.11 intercompany debt agreement to update the definition of capital expenditures to exclude capital expenditures made with respect to 5.11's retail stores from the calculation of

the fixed charge coverage ratio. 5.11 was in compliance with the covenants under their intercompany debt agreement at March 31, 2019. 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. Liberty was not in compliance with the financial covenants under their intercompany loan agreement at December 31, 2018, and we amended the Liberty intercompany debt agreement to grant a waiver to them through the quarter ended December 31, 2019. Clean Earth was not in

compliance with the financial covenants under their intercompany loan agreement at December 31, 2018 as a result of financing various add-on acquisitions during the year, and we amended the Clean Earth intercompany debt agreement to grant a waiver to them through the quarter ended December 31, 2019. Except as previously noted, all of our subsidiaries were in compliance with the financial covenants included within their intercompany credit arrangements at March 31, 2019.

As of March 31, 2019, we had the following outstanding loans due from each of our businesses:

(in thousands)

5.11 Tactical	\$202,140
Ergobaby	\$53,280
Liberty	\$45,839
Advanced Circuits	\$72,092
Arnold	\$76,930
Clean Earth	\$215,110
Foam Fabricators	\$101,300
Sterno	\$266,690
Velocity Outdoor	\$123,819

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 (the "2018 Credit Facility") to amend and restate the 2014 Credit Facility. 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 (the "2018 Revolving Loan Commitment"), and (ii) a \$500 million term loan (the "2018 Term Loan").

We had \$514.8 million in net availability under the 2018 Revolving Credit Facility at March 31, 2019. The outstanding borrowings under the 2018 Revolving Credit Facility include \$0.3 million of outstanding letters of credit at March 31, 2019.

Senior Notes

On April 18, 2018, we consummated the issuance and sale of \$400 million aggregate principal amount of our 8.000% 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, and to non-U.S. persons under Regulation S under the Securities Act. 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 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. The Notes are general senior unsecured obligations of the Company and are not guaranteed by our subsidiaries.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

The following table reflects required and actual financial ratios as of March 31, 2019 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	2:57:1.0
Total Secured Debt to EBITDA Ratio	Less than or equal to 3.50:1.0	2.12:1.0
Total Debt to EBITDA Ratio	Less than or equal to 5.00:1.0	3.57:1.0

Interest Expense

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

	Three months ended	
	March 31,	
	2019	2018
Interest on credit facilities	\$8,774	\$8,284
Interest on Senior Notes	8,000	—
Unused fee on Revolving Credit Facility	387	452
Amortization of original issue discount	152	255
Unrealized (gain) loss on interest rate derivative ⁽¹⁾	1,099	(2,901)
Other, net	170	92
Interest expense	\$18,582	\$6,182
Average daily balance outstanding - credit facilities	\$709,297	\$808,260
Effective interest rate - credit facilities	6.0	% 3.1 %

⁽¹⁾ 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 March 31, 2019, the current portion of the Swap was in a liability position and had a fair value of \$1.0 million, and the non-current portion of the Swap was in a liability position with a fair value of \$2.0 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 March 31, 2019.

In the above table, we provide the effective interest rate on our credit facilities, including the effect of the Swap, and excluding the interest on our Senior Notes, which is at a fixed 8.000%.

Reconciliation of Non-GAAP Financial Measures

GAAP or U.S. GAAP refer 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; and (v) 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

Three months ended March 31, 2019

	Corporate	5.11	Ergobaby	Liberty	Velocity Outdoor	ACI	Arnold	Clean Earth	Foam	Sterno	Consolidated
Net income (loss) ⁽¹⁾	\$109,622	\$(1,870)	\$1,523	\$153	\$(1,865)	\$3,704	\$137	\$(2,710)	\$604	\$1,446	\$110,744
Adjusted for:											
Provision (benefit) for income taxes	—	(445)	626	118	(693)	1,061	(263)	(1,021)	539	481	403
Interest expense, net	18,410	(4)	—	—	48	(1)	—	129	—	—	18,582
Intercompany interest	(25,463)	4,565	979	1,080	2,779	1,737	1,584	4,589	2,277	5,873	—
Depreciation and amortization	359	5,258	2,119	428	3,312	707	1,644	6,169	3,067	5,485	28,548
EBITDA	102,928	7,504	5,247	1,779	3,581	7,208	3,102	7,156	6,487	13,285	158,277
Gain on sale of business	(121,659)	—	—	—	—	—	—	—	—	—	(121,659)
Other (income) expense	363	(8)	—	43	11	(58)	(2)	136	16	70	571
Noncontrolling shareholder compensation	—	559	225	9	270	6	(15)	388	254	420	2,116
Acquisition expenses and other	—	—	—	—	—	—	—	366	—	—	366
Loss on sale of investment	5,300	—	—	—	—	—	—	—	—	—	5,300
Integration services fee	—	—	—	—	—	—	—	—	281	—	281
Other	—	—	—	266	—	58	—	89	—	—	413
Management fees	9,769	250	125	125	125	125	125	125	188	125	11,082
Adjusted EBITDA	\$(3,299)	\$8,305	\$5,597	\$2,222	\$3,987	\$7,339	\$3,210	\$8,260	\$7,226	\$13,900	\$56,747

⁽¹⁾ Net income (loss) does not include income from discontinued operations for the three months ended March 31, 2019.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Adjusted EBITDA

Three months ended March 31, 2018

	Corporate	5.11	Ergobaby	Liberty	Velocity Outdoor	ACI	Arnold	Clean Earth	Foam	Sterno	Consolidated
Net income (loss) ⁽¹⁾	\$(999)	\$(2,775)	\$674	\$1,318	\$(1,286)	\$3,118	\$91	\$(2,316)	\$(597)	\$1,545	\$(1,227)
Adjusted for:											
Provision (benefit) for income taxes	—	(1,779)	262	452	(485)	887	(135)	(617)	(3)	(443)	(1,861)
Interest expense, net	6,037	8	—	—	73	—	—	64	—	—	6,182
Intercompany interest	(20,021)	4,099	1,316	1,012	1,915	1,887	1,630	3,470	1,172	3,520	—
Depreciation and amortization	508	5,481	2,050	363	2,049	842	1,602	5,579	913	2,988	22,375
EBITDA	(14,475)	5,034	4,302	3,145	2,266	6,734	3,188	6,180	1,485	7,610	25,469
Loss on sale of fixed assets	—	—	—	57	—	—	49	40	6	—	152
Noncontrolling shareholder compensation	—	612	271	19	381	6	36	388	85	541	2,339
Acquisition related expenses	5	—	—	—	—	—	—	—	1,552	632	2,189
Integration services fee	—	—	—	—	375	—	—	—	281	—	656
Loss on foreign currency transaction and other	1,339	—	—	—	—	—	—	—	—	—	1,339
Management fees	9,543	250	125	125	125	125	125	125	94	125	10,762
Adjusted EBITDA ⁽²⁾	\$(3,588)	\$5,896	\$4,698	\$3,346	\$3,147	\$6,865	\$3,398	\$6,733	\$3,503	\$8,908	\$42,906

(1) Net income (loss) does not include loss from discontinued operations for the three months ended March 31, 2018.

(2) As a result of the sale of our Manitoba Harvest subsidiary in February 2019, Adjusted EBITDA for the three months ended March 31, 2019 does not include Adjusted EBITDA from Manitoba Harvest of \$1.1 million.

Edgar Filing: Compass Diversified Holdings - Form 10-Q

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)	Three Months Ended	
	March 31, 2019	March 31, 2018
Net income (loss)	\$110,158	\$(1,621)
Adjustment to reconcile net income (loss) to cash provided by operating activities:		
Depreciation and amortization	28,638	22,933
Gain on sale of businesses	(121,659)	—
Amortization of debt issuance costs and original issue discount	1,079	1,353
Unrealized (gain) loss on interest rate hedges	1,099	(2,901)
Noncontrolling shareholder charges	2,205	2,551
Provision for loss on receivables	696	328
Deferred taxes	(2,323)	(4,311)
Other	334	(177)
Changes in operating assets and liabilities	(29,163)	(11,512)
Net cash provided by (used in) operating activities	(8,936)	6,643
Plus:		
Unused fee on revolving credit facility	387	452
Integration services fee ⁽¹⁾	281	656
Successful acquisition costs	366	2,189
Realized loss from foreign currency ⁽²⁾	363	1,339
Loss on sale of Tilray Common Stock	5,300	—
Changes in operating assets and liabilities	29,163	11,512
Less:		
Payment of interest rate swap	94	706
Maintenance capital expenditures: ⁽³⁾		
Compass Group Diversified Holdings LLC	—	—
5.11 Tactical	212	1,362
Advanced Circuits	188	97
Arnold	1,112	1,252
Clean Earth	1,350	1,257
Ergobaby	71	288
Foam Fabricators	498	398
Liberty	126	61
Manitoba Harvest	—	86
Sterno	452	384
Velocity Outdoor	988	787
Other	403	282
Preferred share distribution	3,781	1,813
Estimated cash flow available for distribution and reinvestment	\$17,649	\$14,018
Distribution paid in April 2019/2018	\$(21,564)	\$(21,564)

(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.

Represents maintenance capital expenditures that were funded from operating cash flow, net of proceeds from the

(3) sale of property, plant and equipment, and excludes growth capital expenditures of approximately \$2.5 million for the three months ended March 31, 2019 and \$6.2 million for the three months ended March 31, 2018.

Seasonality

Earnings of certain of our operating segments are seasonal in nature due to various recurring events, holidays and seasonal weather patterns, as well as the timing of our acquisitions during a given year. Historically, the third and fourth quarter produce the highest net sales during our fiscal year.

Related Party Transactions

Integrations Services Agreements

Foam Fabricators, which was acquired in 2018, 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. Foam Fabricators paid CGM \$2.25 million over the term of the ISA, \$2.0 million in 2018 and \$0.3 million in 2019.

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 months ended March 31, 2019, 5.11 purchased approximately \$1.3 million in inventory from the vendor.

Subsequent Event - Profit Allocation Payments

The sale of Manitoba Harvest in February 2019 qualified as a Sale Event under the Company's LLC Agreement. During the second quarter of 2019, the Company declared a distribution to the Allocation Member in connection with the Sale Event of Manitoba Harvest of \$7.7 million. This distribution will be paid in the second quarter of 2019. The profit allocation distribution was calculated based on the portion of the gain on sale related to the Closing Date Consideration, less the loss on sale of shares that were received as part of the Closing Consideration. An additional profit allocation distribution related to the Sale Event of Manitoba Harvest will be declared subsequent to receipt of the Deferred Consideration in August 2019.

Off-Balance Sheet Arrangements

We have no special purpose entities or off-balance sheet arrangements.

Contractual Obligations

Long-term contractual obligations, except for our long-term debt obligations and operating lease liabilities, 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 March 31, 2019:

(in thousands)	Total	Less than			More than 5 Years
		1 Year	1-3 Years	3-5 Years	
Long-term debt obligations ⁽¹⁾	\$1,369,503	\$63,049	\$127,504	\$211,559	\$967,391
Operating lease obligations ⁽²⁾	146,138	20,530	48,956	32,220	44,432
Purchase obligations ⁽³⁾	510,678	227,814	136,285	111,138	35,441
Total ⁽⁴⁾	\$2,026,319	\$311,393	\$312,745	\$354,917	\$1,047,264

- (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 March 31, 2019, including: (i) shareholder distributions of \$166.4 million; (ii) estimated management fees of \$45.2 million per year over the next five years; and (iii) other
- (3) 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 March 31, 2019 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, 2018, as filed with the Securities and Exchange Commission ("SEC") on February 27, 2019.

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 31st, 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.

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. If qualitative factors are not sufficient to determine that the fair value of a reporting unit is more likely than not to exceed its carrying value, we will perform a quantitative test the reporting unit whereby we estimate the fair value of the reporting unit using an income approach or market approach, or a weighting of the two methods. Under the income approach, we estimate the fair value of our 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 specific economic factors. 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. Under the market approach, we estimate fair value based on market multiples of revenue and earnings derived from comparable public companies with operating characteristics that are similar to the reporting unit. When market comparables are not meaningful or available, we estimate the fair value of the reporting unit using only the income approach.

2019 Annual Impairment Testing - For our annual impairment testing at March 31, 2019, we determined that our Liberty operating segment required quantitative testing because we could not conclude that the fair value of Liberty significantly exceeded its carrying value based on qualitative factors alone. We expect to conclude the goodwill

impairment testing during the quarter ended June 30, 2019. For the reporting units that were tested qualitatively for the 2019 annual impairment testing, the results of the qualitative analysis indicated that it is more likely than not that the fair value exceeded their carrying value.

2018 Annual Impairment Testing - Our Arnold operating segment previously had three separate reporting units. 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. 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. Two of the Arnold reporting units, PMAG and PTM, were tested qualitatively as part of the "before" test, 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%. All of our other reporting units were tested qualitatively as of March 31, 2018, and the results of the qualitative analysis indicated that the fair value 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 \$60.4 million. The results of the qualitative analysis of our other reporting unit's indefinite-lived intangible assets, which we completed as of March 31, 2019, 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 1, 2018 and was adopted using the modified retrospective method for all contracts not completed as of the date of adoption.

The adoption of the new revenue guidance represented 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 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.

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

56

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.

Business Combinations

The acquisitions of our businesses are accounted for under the acquisition method of accounting. Accounting for business combinations requires the use of estimates and assumptions in determining the fair value of assets acquired and liabilities assumed in order to allocate the purchase price. The estimates of fair value of the assets acquired and liabilities assumed are based upon assumptions believed to be reasonable using established valuation methods, taking into consideration information supplied by the management of the acquired entities and other relevant information. The determination of fair values requires significant judgment both by our management team and, when appropriate, valuations by independent third-party appraisers. We amortize intangible assets, such as trademarks and customer relationships, as well as property, plant and equipment, over their economic useful lives, unless those lives are indefinite. We consider factors such as historical information, our plans for the asset and similar assets held by our previously acquired portfolio companies. The impact could result in either higher or lower amortization and/or depreciation expense.

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, 2018. 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, 2018, as filed with the SEC on February 27, 2019.

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 March 31, 2019. 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 March 31, 2019.

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, 2018, as filed with the SEC on February 27, 2019.

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, 2018, as filed with the SEC on February 27, 2019.

ITEM 6. EXHIBITS

Exhibit Number Description

10.1*	<u>First Amendment to the 2018 Credit Facility</u>
31.1*	<u>Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant</u>
31.2*	<u>Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant</u>
32.1**	<u>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</u>
32.2**	<u>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</u>
99.1	<u>Arrangement Agreement, dated February 19, 2019 by and among FHF Holdings Ltd.; 1197879 B.C. Ltd.; Compass Group Diversified Holdings, LLC; and each Shareholder that is, or is made pursuant to the Plan of Arrangement, a party hereto (incorporated by reference to Exhibit 99.1 of the Form 8-K filed on February 20, 2019 (File No. 001-34927)).</u>
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: May 1, 2019

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: May 1, 2019

EXHIBIT INDEX

Exhibit Number Description

10.1*	<u>First Amendment to the 2018 Credit Facility</u>
31.1*	<u>Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant</u>
31.2*	<u>Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant</u>
32.1**	<u>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</u>
32.2**	<u>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</u>
99.1	<u>Arrangement Agreement, dated February 19, 2019 by and among FHF Holdings Ltd.; 1197879 B.C. Ltd.; Compass Group Diversified Holdings, LLC; and each Shareholder that is, or is made pursuant to the Plan of Arrangement, a party hereto (incorporated by reference to Exhibit 99.1 of the Form 8-K filed on February 20, 2019 (File No. 001-34927)).</u>
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.