COMPX INTERNATIONAL INC Form 10-Q August 03, 2016

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES

EXCHANGE ACT OF 1934

For the quarter ended June 30, 2016

Commission file number 1-13905

COMPX INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of 57-0981653 (IRS Employer

Incorporation or organization)

Identification No.)

5430 LBJ Freeway, Suite 1700,

Three Lincoln Centre, Dallas, Texas75240-2697(Address of principal executive offices)(Zip Code)Registrant's telephone number, including area code (972) 448-1400448-1400

Indicate by checkmark:

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 a 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 x No "

Whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No "

Whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer "Accelerated filer "Accelerated filer x Smaller reporting company "

Whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes "No x.

Number of shares of common stock outstanding on July 28, 2016:

Class A: 2,419,107

Class B: 10,000,000

COMPX INTERNATIONAL INC.

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Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.

COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

ASSETS	December 31, 2015	June 30, 2016 (unaudited)
Current assets:		· · · ·
Cash and cash equivalents	\$52,347	\$ 51,300
Accounts receivable, net	8,760	12,386
Inventories, net	15,098	14,124
Prepaid expenses and other	704	1,330
Total current assets	76,909	79,140
Other assets:		
Goodwill	23,742	23,742
Other noncurrent	590	590
Total other assets	24,332	24,332
Property and equipment:		
Land	4,928	4,928
Buildings	21,231	22,517
Equipment	63,539	64,923
Construction in progress	1,567	455
	91,265	92,823
Less accumulated depreciation	57,714	59,526
Net property and equipment	33,551	33,297
Total assets	\$134,792	\$ 136,769

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable and accrued liabilities	\$11,618	\$ 9,968
Income taxes payable to affiliates	470	634
Total current liabilities	12,088	10,602
Noncurrent liabilities -		
Deferred income taxes	5,001	4,975
Stockholders' equity:		
Preferred stock	—	—
Class A common stock	24	24
Class B common stock	100	100
Additional paid-in capital	55,422	55,515
Retained earnings	62,157	65,553
Total stockholders' equity	117,703	121,192
Total liabilities and stockholders' equity	\$134,792	\$ 136,769

See accompanying Notes to Condensed Consolidated Financial Statements.

COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Three months ended June 30,		Six months ended June 30,	
	2015	2016	2015	2016
	(unaudite	d)	(unaudite	ed)
Net sales	\$28,918	\$27,107	\$56,808	\$54,182
Cost of goods sold	19,758	18,621	39,082	37,491
Gross profit	9,160	8,486	17,726	16,691
Selling, general and administrative expense	4,854	4,769	9,719	9,621
Operating income	4,306	3,717	8,007	7,070
Interest income	8	41	16	73
Income before taxes	4,314	3,758	8,023	7,143
Provision for income taxes	1,504	1,320	2,799	2,505
Net income	\$2,810	\$2,438	\$5,224	\$4,638
Basic and diluted net income per common share	\$0.23	\$0.20	\$0.42	\$0.37
Cash dividends per share	\$0.05	\$0.05	\$0.10	\$0.10
Basic and diluted weighted average shares outstanding	12,407	12,415	12,405	12,413

See accompanying Notes to Condensed Consolidated Financial Statements.

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COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six mont June 30, 2015 (unaudite	2016
Cash flows from operating activities:		
Net income	\$5,224	\$4,638
Depreciation and amortization	1,771	1,850
Deferred income taxes	(224)	(26)
Other, net	216	291
Change in assets and liabilities:		
Accounts receivable, net	(4,348)	(3,634)
Inventories, net	632	851
Accounts payable and accrued liabilities	(2,762)	(1,639)
Accounts with affiliates	174	164
Prepaids and other, net	(95)	(626)
Net cash provided by operating activities	588	1,869
Cash flows from investing activities -		
Capital expenditures	(1,913)	(1,674)
Cash flows from financing activities -		
Dividends paid	(1,240)	(1,242)
Cash and cash equivalents - net change from:		
Operating, investing and financing activities	(2,565)	(1,047)
Balance at beginning of period	45,570	52,347
Balance at end of period	\$43,005	\$51,300
Supplemental disclosures - cash paid for:		
Income taxes	\$2,848	\$2,367

See accompanying Notes to Condensed Consolidated Financial Statements.

COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Six months ended June 30, 2016

(In thousands)

(unaudited)

			Additional		Total	
	Com stock Class		paid-in	Retained	stockholders	8'
	А	В	capital	earnings	equity	
Balance at December 31, 2015	\$24	\$100	\$ 55,422	\$62,157	\$ 117,703	
Net income				4,638	4,638	
Issuance of common stock			93		93	
Cash dividends				(1,242)	(1,242)
Balance at June 30, 2016	\$24	\$100	\$ 55,515	\$65,553	\$ 121,192	

See accompanying Notes to Condensed Consolidated Financial Statements.

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COMPX INTERNATIONAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

(unaudited)

Note 1 – Organization and basis of presentation:

Organization. We (NYSE MKT: CIX) are 87% owned by NL Industries, Inc. (NYSE: NL) at June 30, 2016. We manufacture and sell component products (security products and recreational marine components). At June 30, 2016, Valhi, Inc. (NYSE: VHI) owns 83% of NL's outstanding common stock and a wholly-owned subsidiary of Contran Corporation owns 93% of Valhi's outstanding common stock. All of Contran's outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children, for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran, Valhi, NL and us.

Basis of presentation. Consolidated in this Quarterly Report are the results of CompX International Inc. and its subsidiaries. The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2015 that we filed with the Securities and Exchange Commission ("SEC") on March 3, 2016 (the "2015 Annual Report"). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2015 contained in the United States of America ("GAAP"). Our results of operations for the interim period ended June 30, 2016 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2015 Consolidated Financial Statements contained in our 2015 Annual Report.

Our operations are reported on a 52 or 53-week year. For presentation purposes, annual and quarterly information in the Condensed Consolidated Financial Statements and accompanying notes are presented as ended June 30 and December 31, as applicable. Unless otherwise indicated, references in this report to "we", "us" or "our" refer to CompX International Inc. and its subsidiaries, taken as a whole.

Note 2 – Business segment information:

nths		
	Six month	ns ended
	June 30,	
2016	2015	2016
	1016 2016	Six month June 30,

	(In thousands)		(In thousa	unds)
Net sales:				
Security Products	\$25,059	\$23,195	\$49,716	\$46,609
Marine Components	3,859	3,912	7,092	7,573
Total net sales	\$28,918	\$27,107	\$56,808	\$54,182
Operating income (loss):				
Security Products	\$5,254	\$4,785	\$10,200	\$9,256
Marine Components	606	555	866	889
Corporate operating expenses	(1,554)	(1,623)	(3,059)	(3,075)
Total operating income	4,306	3,717	8,007	7,070
Interest income	8	41	16	73
Income before taxes	\$4,314	\$3,758	\$8,023	\$7,143

Intersegment sales are not material.

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Note 3 – Accounts receivable, net:

	December		
	31, June 30		
	2015	2016	
	(In thous	sands)	
Accounts receivable, net:			
Security Products	\$7,995	\$11,008	
Marine Components	852	1,449	
Allowance for doubtful accounts	(87)	(71)	
Total accounts receivable, net	\$8,760	\$12,386	

Note 4 – Inventories, net:

	December		
	31,	June 30,	
	2015	2016	
	(In thous	ands)	
Raw materials:			
Security Products	\$2,426	\$2,444	
Marine Components	381	369	
Total raw materials	2,807	2,813	
Work-in-process:			
Security Products	7,732	7,518	
Marine Components	1,614	1,314	
Total work-in-process	9,346	8,832	
Finished goods:			
Security Products	2,041	1,792	
Marine Components	904	687	
Total finished goods	2,945	2,479	
Total inventories, net	\$15,098	\$14,124	

Note 5 – Accounts payable and accrued liabilities:

	DecemberJune	
	31, 30,	
	2015	2016
	(In thousands)	
Accounts payable	\$2,671	\$3,207
Accrued liabilities:		
Employee benefits	7,652	5,114

Taxes other than on income	253	389
Customer tooling	320	408
Professional	75	20
Insurance	244	156
Other	403	674
Total accounts payable and accrued liabilities	\$11,618	\$9,968

Note 6 – Provision for income taxes:

	Six mon ended June 30, 2015 (In thous	2016	
Expected tax expense, at the U.S. federal statutory			
income tax rate of 35%	\$2,808	\$2,500	
Domestic production activities deduction	(260)	(218)	
State income taxes	238	208	
Other, net	13	15	
Total income tax expense	\$2,799	\$2,505	

Note 7 – Financial instruments:

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure:

	December	r 31,	June 30,						
	2015		2016						
	Carrying	Fair	Carrying	Fair					
	amount	value	amount	value					
(In thousands)									
Cash and cash equivalents	\$52,347	\$52,347	\$51,300	\$51,300					
Accounts receivable, net	8,760	8,760	12,386	12,386					
Accounts payable	2,671	2,671	3,207	3,207					

Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

Note 8 – Related party transactions:

From time to time, we may have loans and advances outstanding between us and various related parties pursuant to term and demand notes. We generally enter into these loans and advances for cash management purposes. When we loan funds to related parties, we are generally able to earn a higher rate of return on the loan than we would earn if we invested the funds in other instruments, and when we borrow from related parties, we are generally able to pay a lower rate of interest than we would pay if we had incurred third-party indebtedness. While certain of these loans to affiliates may be of a lesser credit quality than cash equivalent instruments otherwise available to us, we believe we

have considered the credit risks in the terms of the applicable loans. In this regard, on August 3, 2016 we entered into an unsecured revolving demand promissory note with Valhi whereby we have agreed to loan Valhi up to \$40 million. Our loan to Valhi bears interest at prime plus 1.00%, payable quarterly, with all principal due on demand, but in any event no earlier than December 31, 2017. The amount of our outstanding loans to Valhi at any time is at our discretion.

Note 9 - Recent accounting pronouncements not yet adopted:

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). This standard replaces existing revenue recognition guidance, which in many cases was tailored for specific industries, with a uniform accounting standard applicable to all industries and transactions. The new standard, as amended, is currently effective for us beginning with the first quarter of 2018. Entities may elect to adopt ASU No. 2014-09 retrospectively for all periods for all contracts and transactions which occurred during the period (with a few exceptions for practical expediency) or retrospectively with a cumulative effect recognized as of the date of adoption. ASU No. 2014-09 is a fundamental rewriting of existing GAAP with respect to revenue recognition, and we are still evaluating the effect the Standard will have on our consolidated financial statements. We currently expect to adopt the standard in the first quarter of 2018. In addition, we have not yet determined the method we will use to adopt the Standard.

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

Business Overview

We are a leading manufacturer of engineered components utilized in a variety of applications and industries. Through our Security Products segment we manufacture mechanical and electronic cabinet locks and other locking mechanisms used in recreational transportation, postal, office and institutional furniture, cabinetry, tool storage and healthcare applications. We also manufacture stainless steel exhaust systems, gauges, throttle controls and trim tabs for the recreational marine and other industries through our Marine Components segment.

General

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly Report that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. In some cases, you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we do not know if these expectations will be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. The factors that could cause actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Quarterly Report and those described from time to time in our other filings with the SEC and include, but are not limited to, the following:

- ·Future demand for our products,
- •Changes in our raw material and other operating costs (such as zinc, brass and energy costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs,
- ·Price and product competition from low-cost manufacturing sources (such as China),
- ·The impact of pricing and production decisions,
- ·Customer and competitor strategies including substitute products,
- ·Uncertainties associated with the development of new product features,
- ·Future litigation,
- ·Potential difficulties in integrating future acquisitions,
- ·Decisions to sell operating assets other than in the ordinary course of business,
- ·Environmental matters (such as those requiring emission and discharge standards for existing and new facilities),
- •The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,
- •The impact of current or future government regulations (including employee healthcare benefit related regulations),
- ·Potential difficulties in upgrading or implementing new manufacturing and accounting software systems,
- •General global economic and political conditions that introduce instability into the U.S. economy (such as changes in the level of gross domestic product in various regions of the world),
- •Operating interruptions (including, but not limited to labor disputes, hazardous chemical leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime, transportation interruptions and cyber-attacks); and
- •Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts.

Should one or more of these risks materialize (or the consequences of such development worsen), or should the underlying assumptions prove incorrect, actual results could differ materially from those currently forecasted or expected. We disclaim any intention or obligation to update or revise any forward-looking statement whether as a result of changes in information, future events or otherwise.

Operations Overview

Operating income was \$3.7 million in the second quarter of 2016 compared to \$4.3 million in the same period of 2015. Operating income for the first six months of 2016 was \$7.1 million compared to \$8.0 million for the comparable period. Our operating income decreased for the quarter and for the first six months of 2016 primarily due to lower Security Products sales.

Our product offerings consist of a significantly large number of products that have a wide variation in selling price and manufacturing cost, which results in certain practical limitations on our ability to quantify the impact of changes in individual product sales quantities and selling prices on our net sales, cost of goods sold and gross profit. In addition, small variations in period-to-period net sales, cost of goods sold and gross profit can result from changes in the relative mix of our products sold.

Results of Operations

	Three months ended June 30,								
	2015 %		2016	%					
	(Dollars in thousands)								
Net sales	\$28,918	100.0%	\$27,107	100.0%					
Cost of goods sold	19,758			68.7 %					
Gross profit	9,160	31.7 %	8,486	31.3 %					
Operating costs and expenses	4,854	16.8 %	4,769	17.6 %					
Operating income	\$4,306		\$3,717	13.7 %					
	Six months ended June 30,								
	2015	%	2016	%					
	(Dollars in thousands)								
Net sales	\$56,808	100.0%	\$54,182	100.0%					
Cost of goods sold	39,082	68.8 %	37,491	69.2 %					
Gross profit	17,726	31.2 %	16,691	30.8 %					
Operating costs and expenses	9,719	17.1 %	9,621	17.8 %					
Operating income	\$8,007	14.1 %	\$7,070	13.0 %					

Net sales. Net sales decreased \$1.8 million in the second quarter of 2016 and \$2.6 million in the first six months of 2016 compared to the respective periods in 2015, primarily due to Security Products sales in 2015 for a government security end-user that, as expected, did not recur in 2016. For the six months ended June 2016, the decrease in Security Products sales was partially offset by increased Marine Components sales to the waterski/wakeboard boat market. Relative changes in selling prices did not have a material impact on net sales comparisons.

Cost of goods sold and gross profit. Cost of goods sold as a percentage of sales increased less than 1% in the second quarter and first six months of 2016 compared to the same periods in 2015. As a result, gross profit as a percentage of net sales decreased slightly over the same periods. Gross profit dollars decreased due to lower sales in the Security Products segment. The decrease in gross profit percentage is primarily due to decreased leverage of fixed manufacturing costs as a result of decreased production volumes during the second quarter and first six months of

2016 partially offset by improved variable contribution margins attributable to relative changes in customer and product mix, primarily in the Security Products segment.

Operating costs and expenses. Operating costs and expenses consist primarily of sales and administrative related personnel costs, sales commissions and advertising expenses, as well as gains and losses on plant, property and equipment. Operating costs and expenses for the second quarter and first six months of 2016 were comparable to the same periods in 2015.

Operating income. As a percentage of net sales, operating income for the second quarter and first six months of 2016 decreased compared to the same periods of 2015 and was primarily impacted by the factors impacting gross profit percentage and operating costs discussed above.

Provision for income taxes. A tabular reconciliation of our actual tax provision to the U.S. federal statutory income tax rate is included in Note 6 to the Condensed Consolidated Financial Statements. Our operations are wholly within the U.S. and therefore our

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effective income tax rate is primarily reflective of the U.S. federal statutory rate, the benefit associated with the U.S. domestic production activities deduction is fully offset by our provision for U.S. state income taxes.

Segment Results

The key performance indicator for our segments is operating income.

	Three m ended June 30,		ths		%		Six mor June 30		s ended		%	
	2015 (Dollars thousand				Chang	e	2015 (Dollars) thousand				Chang	ge
Net sales:												
Security Products	\$25,059		\$23,195	5	-7	%	\$49,716	5	\$46,60	9	-6	%
Marine Components	3,859		3,912		1	%	7,092		7,573		7	%
Total net sales	\$28,918		\$27,107	7	-6	%	\$56,808	3	\$54,18	2	-5	%
Gross profit:												
Security Products	\$8,053		\$7,383		-8	%	\$15,823	3	\$14,66	9	-7	%
Marine Components	1,107		1,103		0	%	1,903		2,022		6	%
Total gross profit	\$9,160		\$8,486		-7	%	\$17,726	5	\$16,69	1	-6	%
Operating income:												
Security Products	\$5,254		\$4,785		-9	%	\$10,200)	\$9,256		-9	%
Marine Components	606		555		-8	%	866		889		3	%
Corporate operating expenses	(1,554)	(1,623)	-4	%	(3,059)	(3,075	5)	-1	%
Total operating income	\$4,306		\$3,717		-14	%	\$8,007		\$7,070		-12	%
Gross profit margin:												
Security Products	32.1	%	31.8	%			31.8	%	31.5	%		
Marine Components	28.7	%	28.2	%			26.8	%	26.7	%		
Total gross profit margin	31.7	%	31.3	%			31.2	%	30.8	%		
Operating income margin:												
Security Products	21.0	%	20.6	%			20.5	%	19.9	%		
Marine Components	15.7	%	14.2	%			12.2	%	11.7	%		
Total operating income margin	14.9	%	13.7	%								