

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Compass Diversified Holdings  
Form 10-Q  
November 02, 2016  
Table of Contents

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

Form 10-Q

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

For the quarterly period ended September 30, 2016

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)

Sixty One Wilton Road

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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller Reporting Company ☐

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 November 1, 2016, there were 54,300,000 shares of Compass Diversified Holdings outstanding.

---

Table of Contents

COMPASS DIVERSIFIED HOLDINGS  
QUARTERLY REPORT ON FORM 10-Q  
For the period ended September 30, 2016  
TABLE OF CONTENTS

	Page Number
<u>Forward-looking Statements</u>	4
Part I <u>Financial Information</u>	
Item 1. <u>Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2016 (unaudited) and December 31, 2015</u>	5
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2016 and 2015 (unaudited)</u>	6
<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2016 and 2015 (unaudited)</u>	7
<u>Condensed Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2016 (unaudited)</u>	8
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2016 and 2015 (unaudited)</u>	9
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	11
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	36
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	69
Item 4. <u>Controls and Procedures</u>	69
Part II <u>Other Information</u>	70
Item 1. <u>Legal Proceedings</u>	70
Item 1A. <u>Risk Factors</u>	70
Item 6. <u>Exhibits</u>	70
<u>Signatures</u>	72

Table of Contents

NOTE TO READER

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

- the "Trust" and "Holdings" refer to Compass Diversified Holdings;
- "businesses," "operating segments," "subsidiaries" and "reporting units" refer to, collectively, the businesses controlled by the Company;
- the "Company" refer to Compass Group Diversified Holdings LLC;
- the "Manager" refer to Compass Group Management LLC ("CGM");
- the "initial businesses" refer to, collectively, Staffmark Holdings, Inc. ("Staffmark"), Crosman Acquisition Corporation, Compass AC Holdings, Inc. ("ACI" or "Advanced Circuits") and Silvue Technologies Group, Inc.;
- the "2014 acquisitions" refer to, collectively, the acquisitions of Clean Earth Holdings, Inc. and Sterno Products;
- the "2015 acquisition" refer to the acquisition of Fresh Hemp Foods Ltd. ("Manitoba Harvest")
- the "2015 dispositions" refer to, collectively, the sales of CamelBak Acquisition Corp. ("CamelBak") and AFM Holding Corp. ("American Furniture" or "AFM")
- the "Trust Agreement" refer to the amended and restated Trust Agreement of the Trust dated as of November 1, 2010;
- the "2011 Credit Facility" refer to a credit agreement (as amended) with a group of lenders led by Toronto Dominion (Texas) LLC, as agent, which provided for the 2011 Revolving Credit Facility and the 2011 Term Loan Facility;
- the "2014 Credit Facility" refer to the credit agreement, as amended from time to time, entered into on June 6, 2014 with a group of lenders led by Bank of America N.A. as administrative agent, which provides for the 2014 Revolving Credit Facility and the 2014 Term Loan Facility;
- the "2014 Revolving Credit Facility" refer to the \$550 million Revolving Credit Facility provided by the 2014 Credit Facility that matures in June 2019;
- the "2014 Term Loan" refer to the \$325 million Term Loan Facility, provided by the 2014 Credit Facility that matures in June 2021;
- the "2016 Incremental Term Loan" refer to the \$250 million Tranche B Term Facility provided by the 2014 Credit Facility (together with the 2014 Term Loan, the "Term Loans");
- the "LLC Agreement" refer to the fourth amended and restated operating agreement of the Company dated as of January 1, 2012; and
- "we," "us" and "our" refer to the Trust, the Company and the businesses together.

Table of Contents

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," or "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.

Table of Contents

## PART I

## FINANCIAL INFORMATION

## ITEM 1. — FINANCIAL STATEMENTS

## Compass Diversified Holdings

## Condensed Consolidated Balance Sheets

(in thousands)

September 30, December 31,  
2016 2015  
(unaudited)

## Assets

## Current assets:

Cash and cash equivalents	\$ 26,389	\$ 85,240
Accounts receivable, net	173,921	105,910
Inventories	231,987	59,905
Prepaid expenses and other current assets	22,893	21,536
Current assets of discontinued operations	—	18,772
Total current assets	455,190	291,363
Property, plant and equipment, net	145,447	115,948
Equity method investment (refer to Note F)	197,742	249,747
Goodwill	485,054	390,655
Intangible assets, net	549,014	350,687
Other non-current assets	13,307	9,819
Non-current assets of discontinued operations	—	12,823
Total assets	\$ 1,845,754	\$ 1,421,042
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 55,111	\$ 46,140
Accrued expenses	84,110	43,767
Due to related party	8,236	5,863
Current portion, long-term debt	5,685	3,250
Other current liabilities	13,024	9,004
Current liabilities of discontinued operations	—	8,455
Total current liabilities	166,166	116,479
Deferred income taxes	103,898	103,635
Long-term debt	714,954	308,639
Other non-current liabilities	26,711	18,960
Non-current liabilities of discontinued operations	—	110
Total liabilities	1,011,729	547,823
Stockholders' equity		
Trust shares, no par value, 500,000 authorized; 54,300 shares issued and outstanding at September 30, 2016 and December 31, 2015	825,321	825,321
Accumulated other comprehensive loss	(7,817)	) (9,804 )
Accumulated (deficit) earnings	(19,706)	) 10,567
Total stockholders' equity attributable to Holdings	797,798	826,084
Noncontrolling interest	36,227	46,219
Noncontrolling interest of discontinued operations	—	916
Total stockholders' equity	834,025	873,219
Total liabilities and stockholders' equity	\$ 1,845,754	\$ 1,421,042
See notes to condensed consolidated financial statements.		



Table of Contents

Compass Diversified Holdings  
Condensed Consolidated Statements of Operations  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
(in thousands, except per share data)				
Net sales	\$200,770	\$140,738	\$525,713	\$405,524
Service revenues	51,515	44,092	134,035	122,923
Total net revenues	252,285	184,830	659,748	528,447
Cost of sales	133,006	91,589	340,576	267,059
Cost of service revenues	36,864	28,671	95,968	88,430
Gross profit	82,415	64,570	223,204	172,958
Operating expenses:				
Selling, general and administrative expense	53,648	36,310	140,702	98,385
Management fees	8,435	6,373	21,394	19,597
Amortization expense	8,423	7,259	23,966	21,455
Loss on disposal of assets	551	—	7,214	—
Operating income	11,358	14,628	29,928	33,521
Other income (expense):				
Interest expense, net	(4,376)	(11,205)	(23,204)	(24,047)
Amortization of debt issuance costs	(687)	(561)	(1,827)	(1,651)
Gain on equity method investment	50,414	11,784	58,680	9,518
Other expense, net	(3,271)	(949)	(1,852)	(983)
Income from continuing operations before income taxes	53,438	13,697	61,725	16,358
Provision for income taxes	4,894	3,688	9,778	9,206
Income from continuing operations	48,544	10,009	51,947	7,152
Income (loss) from discontinued operations, net of income tax	(455)	4,934	473	9,079
Gain on sale of discontinued operations, net of income tax	2,134	151,075	2,134	151,075
Net income	50,223	166,018	54,554	167,306
Less: Net income attributable to noncontrolling interest	682	1,272	1,749	4,006
Less: Income (loss) from discontinued operations attributable to noncontrolling interest	(164)	246	(116)	(755)
Net income attributable to Holdings	\$49,705	\$164,500	\$52,921	\$164,055
Amounts attributable to Holdings				
Income from continuing operations	47,862	8,737	50,198	3,146
Income (loss) from discontinued operations, net of income tax	(291)	4,688	589	9,834
Gain on sale of discontinued operations, net of income tax	2,134	151,075	2,134	151,075
Net income attributable to Holdings	\$49,705	\$164,500	\$52,921	\$164,055
Basic and fully diluted income per share attributable to Holdings (refer to Note L)				
Continuing operations	\$0.72	\$0.14	\$0.59	\$0.01
Discontinued operations	0.03	2.87	0.05	2.96
	\$0.75	\$3.01	\$0.64	\$2.97
Weighted average number of shares of trust stock outstanding – basic and fully diluted	54,300	54,300	54,300	54,300
Cash distributions declared per share (refer to Note L)	\$0.36	\$0.36	\$1.08	\$1.08

See notes to condensed consolidated financial statements.





Table of Contents

Compass Diversified Holdings  
Condensed Consolidated Statements of Comprehensive Income  
(unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
(in thousands)				
Net income	\$50,223	\$166,018	\$54,554	\$167,306
Other comprehensive income (loss)				
Foreign currency translation adjustments	(1,945 )	(5,145 )	3,275	(4,772 )
Pension benefit liability, net	(765 )	12	(1,288 )	341
Other comprehensive income (loss)	(2,710 )	(5,133 )	1,987	(4,431 )
Total comprehensive income, net of tax	47,513	160,885	56,541	162,875
Less: Net income attributable to noncontrolling interests	518	1,518	1,633	3,251
Less: Other comprehensive income (loss) attributable to noncontrolling interests	(268 )	(612 )	929	(589 )
Total comprehensive income attributable to Holdings, net of tax	\$47,263	\$159,979	\$53,979	\$160,213
See notes to condensed consolidated financial statements.				

Table of Contents

Compass Diversified Holdings  
Condensed Consolidated Statement of Stockholders' Equity  
(unaudited)

(in thousands)	Number of Shares	Amount	Accumulated Earnings (Deficit)	Accumulated Other Comprehensive Loss	Stockholders' Equity Attributable to Holdings	Non- Controlling Interest	Non-Controlling Interest Attributable to Disc. Ops.	Total Stockholders' Equity
Balance — January 1, 2016	164,300	\$825,321	\$ 10,567	\$ (9,804 )	\$ 826,084	\$ 46,219	\$ 916	\$ 873,219
Net income	—	—	52,921	—	52,921	1,749	(116 )	54,554
Total comprehensive income, net	—	—	—	1,987	1,987	—	—	1,987
Option activity attributable to noncontrolling shareholders	—	—	—	—	—	3,011	1	3,012
Effect of subsidiary stock options exercise - Liberty	—	—	(578 )	—	(578 )	4,333	—	3,755
Excess tax benefit on stock compensation - Liberty	—	—	—	—	—	366	—	366
Issuance of subsidiary shares - Ergo (refer to Note N)	—	—	4,809	—	4,809	3,392	—	8,201
Repurchase of subsidiary shares - Ergo (refer to Note N)	—	—	(10,945 )	—	(10,945 )	(4,462 )	—	(15,407 )
Purchase of noncontrolling interest - Liberty (refer to Note N)	—	—	(1,007 )	—	(1,007 )	(469 )	—	(1,476 )
Distributions to noncontrolling shareholders - Liberty (refer to Note N)	—	—	—	—	—	(5,253 )	—	(5,253 )
Distributions to noncontrolling shareholders - ACI (refer to Note N)	—	—	—	—	—	(18,377 )	—	(18,377 )
Acquisition of 5.11	—	—	—	—	—	5,718	—	5,718
Disposition of Tridien	—	—	—	—	—	—	(801 )	(801 )
Distribution to Allocation Interest holders (refer to Note L)	—	—	(16,829 )	—	(16,829 )	—	—	(16,829 )
Distributions paid	—	—	(58,644 )	—	(58,644 )	—	—	(58,644 )
Balance — September 30, 2016	154,300	\$825,321	\$ (19,706 )	\$ (7,817 )	\$ 797,798	\$ 36,227	\$ —	\$ 834,025

See notes to condensed consolidated financial statements.



Table of Contents

Compass Diversified Holdings  
Condensed Consolidated Statements of Cash Flows  
(unaudited)

	Nine months ended September 30,	
(in thousands)	2016	2015
Cash flows from operating activities:		
Net income	\$54,554	\$167,306
Income from discontinued operations	473	9,079
Gain on sale of discontinued operations, net	2,134	151,075
Net income from continuing operations	51,947	7,152
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	19,481	15,797
Amortization expense	32,691	24,566
Loss on disposal of assets	7,214	—
Amortization of debt issuance costs and original issue discount	2,363	2,154
Unrealized loss on interest rate swap	8,322	8,044
Noncontrolling stockholder stock based compensation	3,011	2,063
Excess tax benefit from subsidiary stock options exercised	(366)	—
Gain on equity method investment	(58,680)	(9,518)
Deferred taxes	(4,479)	(4,352)
Other	384	259
Changes in operating assets and liabilities, net of acquisition:		
(Increase) decrease in accounts receivable	(8,797)	4,735
Decrease (increase) in inventories	440	(8,730)
Increase in prepaid expenses and other current assets	2,081	953
Increase (decrease) in accounts payable and accrued expenses	1,296	(11,290)
Net cash provided by operating activities - continuing operations	56,908	31,833
Net cash provided by operating activities - discontinued operations	3,686	14,638
Cash provided by operating activities	60,594	46,471
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(528,642)	(98,816)
Purchases of property and equipment	(15,528)	(11,369)
Net proceeds from sale of equity investment	110,685	—
Payment of interest rate swap	(3,114)	(1,502)
Purchase of noncontrolling interest (refer to Note N)	(1,476)	—
Proceeds from sale of business	11,249	244,269
Other investing activities	350	256
Net cash (used in) provided by investing activities - continuing operations	(426,476)	132,838
Net cash provided by investing activities - discontinued operations	9,192	113,756
Cash used in investing activities	(417,284)	246,594

Table of Contents

Compass Diversified Holdings  
Condensed Consolidated Statements of Cash Flows  
(unaudited)

	Nine months ended September 30,	
(in thousands)	2016	2015
Cash flows from financing activities:		
Borrowings under credit facility	633,798	197,000
Repayments under credit facility	(221,719)	(369,163)
Distributions paid	(58,644 )	(58,644 )
Net proceeds provided by noncontrolling shareholders (refer to Note N)	9,473	6,228
Distributions paid to noncontrolling shareholders (refer to Note N)	(23,630 )	—
Distributions paid to allocation interest holders (refer to Note L)	(16,829 )	—
Repurchase of subsidiary stock (refer to Note L)	(15,407 )	—
Excess tax benefit from subsidiary stock options exercised	366	—
Debt issuance costs	(5,993 )	(295 )
Other	(1,008 )	(576 )
Net cash provided by (used in) financing activities	300,407	(225,450)
Foreign currency impact on cash	(3,197 )	(2,593 )
Net (decrease) increase in cash and cash equivalents	(59,480 )	65,022
Cash and cash equivalents — beginning of period <sup>(1)</sup>	85,869	23,703
Cash and cash equivalents — end of period <sup>(2)</sup>	\$26,389	\$88,725

(1) Includes cash from discontinued operations of \$0.6 million at January 1, 2016 and \$1.8 million at January 1, 2015.

(2) Does not include any cash from discontinued operations at September 30, 2015 because Tridien had no cash balance as of that date.

See notes to condensed consolidated financial statements.

Table of Contents

Compass Diversified Holdings

Notes to Condensed Consolidated Financial Statements (unaudited)

September 30, 2016

Note A — Organization and Business Operations

Compass Diversified Holdings, a Delaware statutory trust (the "Trust" or "Holdings"), was incorporated in Delaware on November 18, 2005. Compass Group Diversified Holdings, LLC, a Delaware limited liability company (the "Company" or "CODI"), was also formed on November 18, 2005 with equity interests which were subsequently reclassified as the "Allocation Interests". The Trust and the Company were formed to acquire and manage a group of small and middle-market businesses headquartered in North America. In accordance with the amended and restated Trust Agreement, dated as of April 25, 2006 (the "Trust Agreement"), the Trust is sole owner of 100% of the Trust Interests (as defined in the Company's amended and restated operating agreement, dated as of April 25, 2006 (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 eight businesses, or reportable operating segments, at September 30, 2016. The segments are as follows: 5.11 Acquisition Corp. ("5.11" or "5.11 Tactical"), The Ergo Baby Carrier, Inc. ("Ergobaby"), Liberty Safe and Security Products, Inc. ("Liberty Safe" or "Liberty"), Fresh Hemp Foods Ltd. ("Manitoba Harvest"), Compass AC Holdings, Inc. ("ACI" or "Advanced Circuits"), AMT Acquisition Corporation ("Arnold" or "Arnold Magnetics"), Clean Earth Holdings, Inc. ("Clean Earth"), and Sterno Products, LLC ("Sterno Products"). Refer to Note E for further discussion of the operating segments. The Company also owns a non-controlling interest of approximately 23.3% in Fox Factory Holding Corp. ("FOX") which is accounted for as an equity method investment. 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").

Note B — Presentation and Principles of Consolidation

The condensed consolidated financial statements for the three and nine month periods ended September 30, 2016 and September 30, 2015, 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") 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, 2015.

Seasonality

Earnings of certain of the Company's operating segments are seasonal in nature. Earnings from Liberty are typically lowest in the second quarter due to lower demand for safes at the onset of summer. Earnings from Clean Earth are typically lower in the winter months due to reduced levels of construction and development activity in the Northeastern United States. Sterno Products typically has higher sales in the second and fourth quarter of each year, reflecting the outdoor summer season and the holiday season.

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 third quarter of 2016, the Company completed the sale of Tridien Medical, Inc. ("Tridien"), and during the third quarter of 2015, the Company completed the sale of its subsidiary, CamelBak Products, LLC ("CamelBak"). Additionally, in October 2015, the Company sold its subsidiary, American Furniture Manufacturing, Inc. ("AFM" or "American Furniture") which met the criteria to be classified as a discontinued operation as of September 30, 2015. As a result of these sales, the results of operations of Tridien are reported as discontinued operations in the condensed consolidated statements of operations for the three and nine months ended September 30, 2016 and 2015, and the results of operations of CamelBak and American Furniture are reported as discontinued operations in the condensed consolidated statements of operations for the three and nine months ended September



## Table of Contents

30, 2015. Refer to Note D for additional information. Unless otherwise indicated, the disclosures accompanying the condensed consolidated financial statements reflect the Company's continuing operations.

### Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued an accounting standard update to simplify the presentation of deferred taxes by requiring companies to classify all deferred tax assets and liabilities, along with any related valuation allowances, as noncurrent on the balance sheet. Adoption of this standard is required for annual periods beginning after December 15, 2016 and early adoption is permitted. The Company adopted this guidance early, effective as of January 1, 2016, on a prospective basis, which is permitted under the standard. At January 1, 2016, the Company had \$6.1 million classified as current deferred tax assets which was reclassified to long-term deferred tax assets, and no amount classified as current deferred tax liabilities.

In September 2015, the FASB issued an accounting standard to simplify the accounting for measurement period adjustments in connection with business combinations by requiring that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The standard update is effective for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. The standard update is to be applied prospectively to adjustments of provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements. The amendment was effective for the Company on January 1, 2016.

In April 2015, the FASB issued an accounting standard update intended to simplify the presentation of debt issuance costs in the balance sheet. The new guidance requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. Prior to the issuance of the standard, debt issuance costs were required to be presented in the balance sheet as an asset. In August 2015, the FASB issued additional guidance which addresses the Security and Exchange Commission's ("SEC") comments related to the absence of authoritative guidance within the accounting standard update related to line-of-credit arrangements. The SEC would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance cost ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings under the line of credit arrangement. The guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. Retrospective adoption is required. The Company adopted this guidance on January 1, 2016 and has reclassified debt issuance costs associated with the Company's term debt of \$4.6 million as of December 31, 2015, from long-term assets to long-term debt. Deferred debt issuance costs incurred in connection with the Company's revolving credit facility of \$5.2 million and \$4.9 million at September 30, 2016 and December 31, 2015, respectively, continue to be classified as long-term assets.

### Recently Issued Accounting Pronouncements

In August 2016, the FASB issued an accounting standard update which updates the guidance as to how certain cash receipts and cash payments should be presented and classified within the statement of cash flows. The amended guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted, including adoption in an interim period.

In February 2016, the FASB issued an accounting standard update related to the accounting for leases which will require an entity to recognize right-of-use assets and lease liabilities on its balance sheet and disclose key information about leasing arrangements. The standard update offers specific accounting guidance for a lessee, a lessor and sale and leaseback transactions. Lessees and lessors are required to disclose qualitative and quantitative information about leasing arrangements to enable a user of financial statements to assess the amount, timing and uncertainty of cash flows arising from leases. For public companies, the new standard is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period, and requires modified retrospective adoption, with early adoption permitted. Accordingly, this standard is effective for the Company on January 1, 2019.

The Company is currently assessing impact of the new standard on our consolidated financial statements. In July 2015, the FASB issued an accounting standard update intended to simplify the subsequent measurement of inventory by requiring inventory to be measured at the lower of cost and net realizable value. The new guidance applies only to inventory that is determined by methods other than last-in-first-out and the retail inventory method. The Company does not believe that the adoption of this new accounting guidance will have a significant impact on its consolidated financial statements. The guidance is effective for public companies for annual reporting periods beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption of the guidance is permitted.

Table of Contents

In May 2014, the FASB issued a comprehensive new revenue recognition standard. The new standard outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard is designed to create greater comparability for financial statement users across industries, jurisdictions and capital markets and also requires enhanced disclosures. On July 9, 2015, the FASB voted to defer the effective date by one year to December 15, 2017 for interim and annual reporting periods beginning after that date and permitted early adoption of the standard, but not before the original effective date of December 15, 2016. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

## Note C — Acquisitions

## Acquisition of 5.11 Tactical

On August 31, 2016, 5.11 ABR Merger Corp. ("Merger Sub"), a wholly owned subsidiary of 5.11 ABR Corp. ("Parent"), which in turn is a wholly owned subsidiary of the Company, merged with and into 5.11 Tactical, with 5.11 Tactical as the surviving entity, pursuant to an agreement and plan of merger among Merger Sub, Parent, 5.11 Tactical, and TA Associates Management L.P. entered into on July 29, 2016.

5.11 Tactical is a leading provider of purpose-built tactical apparel and gear crafted 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.

The Company made loans to, and purchased a 97.5% controlling interest in 5.11 ABR Corp.. The purchase price, including proceeds from noncontrolling interest and net of transaction costs, was approximately \$405.1 million. The Company funded its portion of the acquisition through an amendment to the 2014 Credit Facility that allowed for an increase in the 2014 Revolving Credit Facility and the 2016 Incremental Term Loan (refer to Note I - Debt). 5.11 management invested in the transaction along with the Company, representing approximately 2.5% initial noncontrolling interest on a primary and fully diluted basis. The fair value of the noncontrolling interest was determined based on the enterprise value of the acquired entity multiplied by the ratio of the number of shares acquired by the minority holders to total shares. The transaction was accounted for as a business combination. CGM acted as an advisor to the Company in the acquisition and will continue to provide integration services during the first year of the Company's ownership of 5.11. CGM will receive integration service fees of \$3.5 million payable quarterly over a twelve month period as services are rendered beginning in the quarter ended December 31, 2016.

The results of operations of 5.11 Tactical have been included in the consolidated results of operations since the date of acquisition. 5.11's results of operations are reported as a separate operating segment. The table below provides the preliminary recording of assets acquired and liabilities assumed as of the acquisition date.

## 5.11 Tactical

(in thousands)

Amounts recognized as of the acquisition date

Assets:

Cash \$12,581

Accounts receivable <sup>(1)</sup> 38,323

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Inventory <sup>(2)</sup>	163,507
Property, plant and equipment <sup>(3)</sup>	22,723
Intangible assets	127,706
Goodwill	76,186
Other current and noncurrent assets	5,316
Total assets	446,342

13

---

Table of Contents

## Liabilities and noncontrolling interest:

Current liabilities	\$38,229
Other liabilities	180,231
Deferred tax liabilities	—
Noncontrolling interest	5,568
Total liabilities and noncontrolling interest	224,028

Net assets acquired	222,314
Noncontrolling interest	5,568
Intercompany loans to business	179,237
	\$407,119

## Acquisition Consideration

Purchase price	\$400,000
Working capital adjustment	(910 )
Cash	8,029
Total purchase consideration	\$407,119
Less: Transaction costs	2,063
Purchase price, net	\$405,056

(1) Includes \$40.1 million of gross contractual accounts receivable of which \$1.7 million was not expected to be collected. The fair value of accounts receivable approximated book value acquired.

(2) Includes \$42.3 million in inventory basis step-up, which will be charged to cost of goods sold over the inventory turns of the acquired entity.

(3) Includes \$7.6 million of property, plant and equipment basis step-up.

The Company incurred \$2.1 million of transaction costs in conjunction with the 5.11 acquisition, which was included in selling, general and administrative expense in the consolidated statements of income during that period. The preliminary allocation of the purchase price presented above is 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 are based on, but not limited to, expected future revenue and cash flows, expected future growth rates and estimated discount rates. Current and noncurrent assets and current and other liabilities are estimated at their historical carrying values. Property, plant and equipment is valued through a preliminary purchase price appraisal and will be depreciated on a straight-line basis over the respective remaining useful lives. Goodwill is 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 goodwill of \$76.2 million reflects the strategic fit of 5.11 in the Company's branded products business and is not expected to be deductible for income tax purposes.

The intangible assets recorded related to the 5.11 acquisition are as follows (in thousands):

Intangible assets	Amount	Estimated Useful Life
Trade name	\$48,665	20 years
Customer relationships	74,343	10 - 15 years
Technology	4,698	10 years
	\$127,706	



Table of Contents

The customer relationships intangible asset was valued at \$74.3 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 and of the other assets utilized in the business. Customer relationships intangible asset was derived using a risk-adjusted discount rate. The tradename intangible asset and the design patent technology asset were valued using a royalty savings 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.

## Acquisition of Manitoba Harvest

On July 10, 2015, FHF Holdings Ltd., a majority owned subsidiary of the Company, and 1037269 B.C. Ltd., a wholly owned subsidiary of FHF Holdings Ltd. (together, the "Buyer"), closed on the acquisition of all the issued and outstanding capital stock of Fresh Hemp Foods Ltd. ("Manitoba Harvest"). Subsequent to the closing, 1037269 B.C. Ltd. merged with and into Manitoba Harvest. Headquartered in Winnipeg, Manitoba, Manitoba Harvest is a global leader in branded, hemp-based foods.

The Company made loans to and purchased an 87% controlling interest in Manitoba Harvest. The purchase price, including proceeds from noncontrolling interest, was approximately \$102.7 million (C\$130.3 million). Manitoba Harvest management and a minority shareholder invested in the transaction along with the Company representing approximately 13% initial noncontrolling interest on a primary basis. The fair value of the noncontrolling interest was determined based on enterprise value of the acquired entity multiplied by the ratio number of shares acquired by the minority shareholders to total shares. The transaction was accounted for as a business combination. CGM acted as an advisor to the Company in the acquisition and will continue to provide integration services during the first year of the Company's ownership of Manitoba Harvest. CGM received integration services fees of \$1.0 million which were payable quarterly during the twelve month period subsequent to acquisition as services are rendered.

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

## Manitoba Harvest

(in thousands)

Amounts recognized as of the acquisition date

## Assets:

Cash	\$ 164
Accounts receivable	3,787
Inventory <sup>(1)</sup>	8,743
Property, plant and equipment	8,203
Goodwill	37,882
Intangible assets	63,687
Other current and noncurrent assets	986
Total assets	\$ 123,452

## Liabilities and noncontrolling interest:

Current liabilities	\$ 3,267
Deferred tax liabilities	16,593
Other liabilities	23,332
Noncontrolling interest	7,638
Total liabilities and noncontrolling interest	\$ 50,830

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Net assets acquired	\$ 72,622
Noncontrolling interest	7,638
Intercompany loans to business	23,593
	\$ 103,853

15

---



Table of Contents

## Acquisition Consideration

Purchase price	\$104,437
Working capital adjustment	(584 )
Total purchase consideration	\$103,853
Less: Transaction costs	1,145
Purchase price, net	\$102,708

<sup>(1)</sup> Includes \$3.1 million of step-up in the basis of inventory.

The Company incurred \$1.1 million of transaction costs in conjunction with the acquisition of Manitoba Harvest during 2015 which were included in selling, general and administrative expenses in the consolidated statements of income during the year ended December 31, 2015. The goodwill of \$37.9 million, which is not expected to be deductible for tax purposes, reflects the strategic fit of Manitoba Harvest into the Company's branded products businesses.

The values assigned to the identified intangible assets were determined by discounting estimated future cash flows associated with these assets to their present value. The intangible assets recorded in connection with the Manitoba Harvest acquisition are as follows (in thousands):

Intangible assets	Amount	Estimated Useful Life
Tradename (unamortizable)	\$13,005	N/A
Technology and processes	9,616	10 years
Customer relationships	41,066	15 years
	\$63,687	

## Unaudited pro forma information

The following unaudited pro forma data for the three and nine months ended September 30, 2016 and September 30, 2015 gives effect to the acquisition of Manitoba Harvest and 5.11 Tactical, as described above, as if the acquisitions had been completed as of January 1, 2015, and the sale of CamelBak, AFM and Tridien as if the dispositions had been completed on January 1, 2015. 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		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$299,737	\$271,488	\$845,212	\$766,929
Operating income	11,769	20,913	29,603	42,755
Net income (loss)	46,468	9,284	38,989	(1,163 )
Net income (loss) attributable to Holdings	45,795	8,033	37,271	(5,515 )
Basic and fully diluted net income (loss) per share attributable to Holdings	\$0.68	\$0.13	\$0.40	\$(0.15 )

## Table of Contents

### Other acquisitions

#### Ergobaby

On May 11, 2016, the Company's Ergobaby subsidiary acquired all of the outstanding membership interests in New Baby Tula LLC ("Baby Tula"), a maker of premium baby carriers, toddler carriers, slings, blankets and wraps. The purchase price was \$73.8 million, net of transaction costs, plus a potential earn-out of \$8.2 million based on 2017 financial performance. Ergobaby paid \$0.8 million in transaction costs in connection with the acquisition. Ergobaby funded the acquisition and payment of related transaction costs through the issuance of an additional \$68.2 million in inter-company loans with the Company, and the issuance of \$8.2 million in Ergobaby shares to the selling shareholders. The fair value of the Ergobaby shares issued to the selling shareholders was determined based on a model that multiplies the trailing twelve months earnings before interest, taxes, depreciation and amortization by an estimated enterprise value multiple to determine an estimated fair value. The fair value calculation assumes proceeds from the conversion of outstanding stock options, deducts the carrying value of debt at Ergobaby and estimated selling costs of the entity, and divides the resulting amount by the total number of outstanding shares, including converted stock options, to determine a per share value for the stock issued. The Company funded the additional inter-company loans used for the acquisition with available cash on the balance sheet and a draw on the 2014 Revolving Credit Facility. Ergobaby recorded a preliminary purchase price allocation of \$13.2 million in goodwill, which is expected to be deductible for income tax purposes, \$55.3 million in intangible assets comprised of \$52.9 million in finite lived tradenames, \$1.7 million in non-compete agreements; and \$0.7 million in customer relationships, and \$4.8 million in inventory step-up. \$3.7 million of the inventory step-up has been charged to cost of goods sold during the quarter ended September 30, 2016, and the remaining amount will be charged to cost of goods sold during the fourth quarter of 2016. In addition, the earn-out provision of the purchase price was allocated a fair value of \$3.8 million. The remainder of the purchase consideration was allocated to net assets acquired. Ergobaby paid \$0.7 million in transaction costs related to the acquisition of Baby Tula. The Company expects to finalize the purchase price during the fourth quarter of 2016.

#### Clean Earth

On June 1, 2016, the Company's Clean Earth subsidiary acquired certain of the assets and liabilities of EWS Alabama, Inc. ("EWS"). Clean Earth funded the acquisition and the related transaction costs through the issuance of additional inter-company debt with the Company. Based in Glencoe, Alabama, EWS provides a range of hazardous and non-hazardous waste management services from a fully permitted hazardous waste RCRA Part B facility. The Company funded the additional inter-company loans with Clean Earth through a draw on its 2014 Revolving Credit Facility. In connection with the acquisition, Clean Earth recorded a preliminary purchase price allocation of \$3.3 million in goodwill and \$12.1 million in intangible assets. The Company expects to finalize the purchase price during the fourth quarter of 2016.

On April 15, 2016, Clean Earth acquired certain assets of Phoenix Soil, LLC ("Phoenix Soil") and WIC, LLC (together with Phoenix Soil, the "Sellers"). Phoenix Soil is based in Plainville, CT and provides environmental services for nonhazardous contaminated soil materials with a primary focus on soil. Phoenix Soil recently completed its transition to a new 58,000 square foot thermal desorption facility owned by WIC, LLC. The acquisition increases Clean Earth's soil treatment capabilities and expand its geographic footprint into New England. Clean Earth financed the acquisition and payment of related transaction costs through the issuance of additional inter-company loans with the Company. The Company used cash on hand to fund the purchase price of Phoenix Soil. In connection with the acquisition, Clean Earth recorded a preliminary purchase price allocation of \$3.2 million in goodwill and \$5.6 million in intangible assets in the second quarter of 2016. The Company expects to finalize the purchase price during the fourth quarter of 2016.

#### Sterno Products

On January 22, 2016, Sterno Products, a wholly owned subsidiary of the company, acquired all of the outstanding stock of Northern International, Inc. (NII), for a total purchase price of approximately \$35.8 million (C\$50.6 million), plus a potential earn-out opportunity payable over the next two years up to a maximum amount of \$1.8 million (C\$2.5

million), and is subject to working capital adjustments. The contingent consideration was fair valued on a preliminary basis at \$1.5 million, based on probability weighted models of the achievement of certain performance based financial targets. Refer to Note K - "Fair Value Measurements". for a description of the valuation technique used to fair value the contingent consideration. Headquartered in Coquitlam, British Columbia, Canada, NII sells flameless candles and outdoor lighting products through the retail segment. Sterno Products financed the acquisition and payment of the related transaction costs through the issuance of an additional \$37.0 million in inter-company loans with the Company.

In connection with the acquisition, Sterno recorded a purchase price allocation of \$6.0 million of goodwill, which is not expected to be deductible for income tax purposes, \$12.7 million in intangible assets and \$1.2 million in inventory step-up. In addition, the earn-out provision of the purchase price was allocated a fair value of \$1.5 million. The remainder of the purchase consideration

Table of Contents

was allocated to net assets acquired. Sterno Products incurred \$0.4 million in acquisition related costs in connection with the NII acquisition.

**Manitoba Harvest**

On December 15, 2015, the Company's Manitoba Harvest subsidiary completed the acquisition of Hemp Oil Canada, Inc. (HOCI), for a purchase price of \$30.4 million (C\$41.5 million). The final purchase price was reduced by \$0.4 million (C\$0.5 million) after the settlement of the working capital adjustment during the second quarter of 2016.

HOCI is a bulk wholesale producer, private label packager and custom processor of hemp food product ingredients, located in Ste. Agathe, Manitoba. Manitoba Harvest incurred \$0.4 million (C\$0.5 million) of acquisition related costs for the HOCI acquisition which are recorded in selling, general and administrative expenses in the consolidated results of operation for the year ending December 31, 2015. In connection with the acquisition of HOCI, certain of the selling shareholders of HOCI invested \$6.8 million (C\$9.3 million) in Manitoba Harvest in exchange for approximately 11% noncontrolling interest in Manitoba Harvest.

Manitoba Harvest recorded a purchase price allocation of \$7.3 million in goodwill, which is expected to be deductible for income tax purposes, \$10.8 million of intangible assets, and \$0.3 million in inventory step-up. The remainder of the purchase consideration was allocated to net assets acquired.

**Note D - Discontinued operations****Sale of Tridien**

On September 21, 2016, the Company sold its majority owned subsidiary, Tridien, based on an enterprise value of \$25 million. After the allocation of the sale proceeds to non-controlling equity holders and the payment of transaction expenses, the Company received approximately \$22.7 million in net proceeds at closing related to its debt and equity interests in Tridien. The Company recognized a gain of \$1.5 million for the three and nine months ended September 30, 2016 as a result of the sale of Tridien. Approximately \$1.6 million of the proceeds received by the Company from the sale of Tridien have been reserved to support the Company's indemnification obligations for future claims against Tridien that the Company may be liable for under the terms of the Tridien sale agreement.

The following table presents summary balance sheet information of the Tridien business that is presented as discontinued operations as of December 31, 2015 (in thousands):

	December 31, 2015
<b>Assets:</b>	
Cash	\$ 629
Accounts receivable	8,410
Inventories	8,466
Prepaid expenses and current assets	1,267
Current assets of discontinued operations	\$ 18,772
Property, plant and equipment, net	2,103
Goodwill	7,833
Intangible assets, net	2,717
Other noncurrent assets	170
Noncurrent assets of discontinued operations	\$ 12,823
<b>Liabilities</b>	
Accounts payable	4,263
Accrued expenses and other current liabilities	4,192
Current liabilities of discontinued operations	\$ 8,455
Noncurrent liabilities of discontinued operations	\$ 110

Noncontrolling interest of discontinued operations \$ 916

Table of Contents

## Sale of CamelBak

On August 3, 2015, the Company sold its majority owned subsidiary, CamelBak, based on a total enterprise value of \$412.5 million. The CamelBak purchase agreement contains customary representations, warranties, covenants and indemnification provisions, and the transaction is subject to customary working capital adjustments.

The Company received approximately \$367.8 million in cash related to its debt and equity interests in CamelBak after payments to noncontrolling shareholders and payment of all transaction expenses. The Company recognized a gain of \$164.0 million, net of tax, during 2015 as a result of the sale of CamelBak. During the third quarter of 2016, the Company settled the outstanding working capital adjustments related to CamelBak, resulting in the recognition of additional gain on the sale of business of \$0.6 million during the quarter ended September 30, 2016.

## Sale of AFM

On October 5, 2015, the Company sold its majority owned subsidiary, American Furniture, for a sale price of \$24.1 million. The Company received approximately \$23.5 million in net proceeds related to its debt and equity interests in American Furniture after payment of all transaction expenses. The Company recognized a loss on the sale of American Furniture of \$14.3 million during 2015.

## Operating results of discontinued operations

Summarized operating results of discontinued operations for the three and nine months ended September 30, 2016 and 2015 are as follows:

	Three months ended September 30, 2016 <sup>(1)</sup>	Nine months ended September 30, 2016 <sup>(1)</sup>
(in thousands)	Tridien	Tridien
Net sales	\$ 15,978	\$ 45,951
Gross profit	3,223	7,917
Operating income	967	437
Income (loss) from continuing operations before income taxes	(440)	) 488
Provision for income taxes	15	15
Income (loss) from discontinued operations <sup>(2)</sup>	\$ (455)	) \$ 473

<sup>(1)</sup> The results of operations of Triden for the three and nine months ended September 30, 2016 include the results from July 1, 2016 through the date of disposition and January 1, 2016 through the date of disposition, respectively.

<sup>(2)</sup> The results for the three and nine months ended September 30, 2016 exclude \$0.4 million and \$1.1 million of intercompany interest expense.

	Three months ended September 30, 2015				Nine months ended September 30, 2015			
(in thousands)	CamelBak <sup>(1)</sup>	American Furniture	Tridien	Total discontinued operations	CamelBak <sup>(1)</sup>	American Furniture	Tridien	Total discontinued operations
Net sales	\$17,023	\$39,068	\$23,318	\$79,409	\$96,519	\$122,420	\$58,850	\$277,789
Gross profit	7,282	3,656	4,409	15,347	41,415	11,613	11,807	64,835
Operating income (loss)	2,713	901	1,183	4,797	14,348	4,126	(6,504)	) 11,970

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Income (loss) from continuing operations before income taxes	4,315	902	1,183	6,400	16,607	4,134	(6,503 )	14,238
Provision for income taxes	1,355	43	68	1,466	5,010	81	68	5,159
Income (loss) from discontinued operations <sup>(2)</sup>	\$2,960	\$ 859	\$ 1,115	\$ 4,934	\$11,597	\$4,053	\$(6,571 )	\$ 9,079

<sup>(1)</sup> The results of operations of Camelbak for the three and nine months ended September 30, 2015 include the results from July 1, 2015 through the date of disposition and January 1, 2015 through the date of disposition, respectively.

Table of Contents

(2) The results for the three and nine months ended September 30, 2015 exclude \$2.9 million and \$7.7 million of intercompany interest expense.

Note E — Operating Segment Data

At September 30, 2016, the Company had eight 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 crafted 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 premier designer, marketer and distributor of wearable baby carriers and related baby wearing products, as well as infant travel systems (strollers, car seats and accessories). Ergobaby offers a broad range of wearable baby carriers, infant travel systems and related products that are sold through more than 450 retailers and web shops in the United States and throughout the world. Ergobaby has two main product lines: baby carriers (baby carriers and accessories) and infant travel systems (strollers, car seats and accessories). 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 314,000 square foot manufacturing facility, Liberty produces a wide range of home and gun safe models in a broad assortment of sizes, features and styles. Liberty is headquartered in Payson, Utah.

Manitoba Harvest is a pioneer and leader in the manufacture and distribution of branded, hemp-based foods and hemp based ingredients. Manitoba Harvest's products, which include Hemp Hearts™, Hemp Heart Bites™, Hemp Heart Bars™, and Hemp protein powders, are currently carried in over 7,000 retail stores across the U.S. and Canada. Manitoba Harvest is headquartered in Winnipeg, Manitoba.

Advanced Circuits, an electronic components manufacturing company, is a provider of 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 Magnetics is a leading global manufacturer of engineered magnetic solutions for a wide range of specialty applications and end-markets, including energy, medical, aerospace and defense, consumer electronics, general industrial and automotive. Arnold Magnetics produces high performance permanent magnets (PMAG), flexible magnets (FlexMag) and precision foil products (Precision Thin Metals) 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 Magnetics is headquartered in Rochester, New York.

•



Clean Earth provides environmental services for a variety of contaminated materials including soils, dredged material, hazardous waste and drill cuttings. Clean Earth analyzes, treats, documents and recycles waste streams generated in multiple end-markets such as power, construction, oil and gas, infrastructure, industrial and dredging. Clean Earth is headquartered in Hatboro, Pennsylvania and operates 16 facilities in the eastern United States.

Sterno Products is a manufacturer and marketer of portable food warming fuel and creative table lighting solutions for the food service industry and flameless candles and outdoor lighting products for consumers. Sterno Products's products include wick and gel chafing fuels, butane stoves and accessories, liquid and traditional wax candles, catering equipment and outdoor lighting products. Sterno Products 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.

Table of Contents

A disaggregation of the Company's consolidated revenue and other financial data for the three and nine months ended September 30, 2016 and 2015 is presented below (in thousands):

Net sales of operating segments	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
5.11 Tactical	\$27,203	\$—	\$27,203	\$—
Ergobaby	29,664	21,944	75,048	64,104
Liberty	23,810	23,404	74,713	74,013
Manitoba Harvest	15,920	8,856	44,321	8,856
ACI	21,679	22,234	64,945	66,734
Arnold Magnetics	26,912	32,590	82,791	93,138
Clean Earth	51,515	44,092	134,035	122,922
Sterno Products	55,582	31,710	156,692	98,680
Total	252,285	184,830	659,748	528,447
Reconciliation of segment revenues to consolidated revenues:				
Corporate and other	—	—	—	—
Total consolidated revenues	\$252,285	\$184,830	\$659,748	\$528,447

Profit (loss) of operating segments <sup>(1)</sup>	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
5.11 Tactical	\$(1,794 )	\$—	\$(1,794 )	\$—
Ergobaby	4,671	5,717	9,101	16,764
Liberty	2,417	3,545	9,879	7,713
Manitoba Harvest	554	(3,955 )	(865 )	(3,955 )
ACI	5,759	6,295	17,241	18,782
Arnold Magnetics	851	3,058	3,828	6,532
Clean Earth	3,593	4,893	5,860	4,933
Sterno Products	5,536	2,707	14,095	8,286
Total	21,587	22,260	57,345	59,055
Reconciliation of segment profit to consolidated income (loss) before income taxes:				
Interest expense, net	(4,376 )	(11,205 )	(23,204 )	(24,047 )
Other income, net	(3,271 )	(949 )	(1,852 )	(983 )
Gain on equity method investment	50,414	11,784	58,680	9,518
Corporate and other <sup>(2)</sup>	(10,916 )	(8,193 )	(29,244 )	(27,185 )
Total consolidated loss before income taxes	\$53,438	\$13,697	\$61,725	\$16,358

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

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

Table of Contents

	Accounts Receivable		Identifiable Assets		Depreciation and Amortization Expense			
	Sept. 30,	December 31,	Sept. 30,	December 31,	Three months ended		Nine months ended	
	2016	2015	2016 <sup>(1)</sup>	2015 <sup>(1)</sup>	September 30,		September 30,	
5.11 Tactical	\$45,321	\$—	\$322,200	\$—	\$5,192	\$—	\$5,192	\$—
Ergobaby	11,768	8,076	116,660	62,436	4,409	876	6,046	2,596
Liberty	13,000	12,941	27,931	31,395	616	648	1,925	2,880
Manitoba Harvest	8,249	5,512	100,833	88,541	1,732	4,011	5,200	4,048
ACI	6,166	5,946	18,298	17,275	885	726	2,585	2,207
Arnold Magnetics	16,269	15,083	64,987	72,310	2,268	2,182	6,778	6,561
Clean Earth	44,705	42,291	199,621	185,087	5,989	5,082	16,019	15,541
Sterno Products	34,373	19,508	137,780	121,910	2,396	2,155	8,427	5,775
Allowance for doubtful accounts	(5,930)	(3,447)	—	—	—	—	—	—
Total	173,921	105,910	988,310	578,954	23,487	15,680	52,172	39,608
Reconciliation of segment to consolidated total:								
Corporate and other identifiable assets	—	—	727	64,180	—	—	—	755
Equity method investment	—	—	197,742	249,747	—	—	—	—
Amortization of debt issuance costs and original issue discount	—	—	—	—	888	729	2,363	2,154
Assets of discontinued operations	—	—	—	31,596	—	—	—	—
Total	\$173,921	\$105,910	\$1,186,779	\$924,477	\$24,375	\$16,409	\$54,535	\$42,517

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

## Geographic Information

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
5.11 Tactical	\$6,141	\$—	\$6,141	\$—
Ergobaby	16,701	12,829	40,660	36,059
Manitoba Harvest	8,573	5,206	20,983	5,206
Arnold Magnetics	12,208	10,798	33,654	33,812
Sterno Products	6,327	883	16,366	2,564
	\$49,950	\$29,716	\$117,804	\$77,641

## Note F - Equity Method Investment

## Investment in FOX

FOX, a former majority owned subsidiary of the Company that is publicly traded on the NASDAQ Stock Market under the ticker "FOX," is a designer, manufacturer and marketer of high-performance ride dynamic products used

primarily for bicycles, side-by-side vehicles, on-road vehicles with off-road capabilities, off-road vehicles and trucks, all-terrain vehicles, snowmobiles, specialty vehicles and applications, and motorcycles. FOX's products offer innovative design, performance, durability and reliability that enhance ride dynamics by improving performance and control. FOX is headquartered in Scotts Valley, California. In July 2014, FOX used a registration statement on Form S-1 under the Securities Act filed with the Securities and Exchange

Table of Contents

Commission for a public offering of its common stock (the "FOX Secondary Offering"). CODI sold 4,466,569 shares of FOX common stock in connection with the FOX Secondary Offering. As a result of the sale of the shares by the Company in the FOX Secondary Offering, the Company's ownership interest in FOX decreased to approximately 41.2%, which resulted in the deconsolidation of the FOX operating segment in the Company's consolidated financial statements effective as of the date of the FOX Secondary Offering.

On March 15, 2016, the Company sold 2,500,000 of its FOX shares through a secondary offering (the "March Offering") at a price of \$15.895 per share, which represented an underwriter's discount of 8.5% from the FOX share closing price on the date the offering was priced. Concurrently with the March Offering, FOX purchased 500,000 shares of their shares directly from the Company, also at a price of \$15.895 per share. As a result of the sale of shares through the March Offering and the repurchase of shares by FOX, the Company sold a total of 3,000,000 shares of FOX common stock, with total net proceeds of approximately \$47.7 million. Upon completion of the March Offering and repurchase of shares by FOX, the Company's ownership interest in FOX was reduced from approximately 41.2% to 33.1%. During the third quarter of 2016, FOX closed on a secondary public offering (the "August Offering") of 4,025,000 shares held by certain FOX shareholders, including the Company. The Company sold a total of 3,500,000 shares of FOX common stock in the August Offering, for total net proceeds of \$63.0 million. Upon completion of the August Offering, the Company's ownership of FOX decreased from approximately 33% to approximately 23%. The Company currently owns approximately 8.6 million shares of FOX common stock.

The sale of the FOX shares in the March Offering and August Offering qualified as a Sale Event under the Company's LLC Agreement. The Company's Board of Directors declared a distribution to the Holders of the Allocation Interests of \$8.6 million and \$11.6 million, respectively, in connection with the Sale Events of FOX. The profit allocation payment related to the March Offering was made in the quarter ended June 30, 2016, and the profit allocation related to the August Offering will be made during the quarter ended December 31, 2016. The profit allocation for the August Offering will total a net distribution to Holders of \$7.0 million after the effect of the Sale Event related to Tridien is used to offset this payment.

The Company has elected to account for its investment in FOX at fair value using the equity method beginning on the date the investment became subject to the equity method of accounting. The Company uses the equity method of accounting when it has the ability to exercise significant influence, but not control, over the operating and financial policies of the investee. For equity method investments which the Company has elected to measure at fair value, unrealized gains and losses are reported in the consolidated statement of operations as gain (loss) from equity method investments. The equity method investment in FOX had a fair value of \$197.7 million on September 30, 2016 based on the closing price of FOX shares on that date. The Company recognized a gain of \$50.4 million and \$58.7 million, respectively, for the three and nine months ended September 30, 2016 due to the change in the fair value of the FOX investment and the effect of the underwriter's discount on the sale of FOX shares.

The condensed balance sheet information and results of operations of the Company's FOX investment are summarized below (in thousands):

Condensed Balance Sheet  
information

	September 30, 2016	December 31, 2015
Current assets	\$ 170,837	\$ 131,941
Non-current assets	153,738	145,775
	\$ 324,575	\$ 277,716
Current liabilities	\$ 80,795	\$ 73,970
Non-current liabilities	69,562	51,486
Stockholders' equity	174,218	152,260

\$324,575 \$277,716

Table of ContentsCondensed Results of  
Operations

	Three months ended		Nine months ended	
	September	September	September	September
	30, 2016	30, 2015	30, 2016	30, 2015
Net revenue	\$109,011	\$106,171	\$291,522	\$271,130
Gross profit	34,886	34,786	92,331	83,437
Operating income	15,086	13,821	32,057	25,897
Net income	\$13,684	\$10,591	\$25,862	\$18,124

## Note G — Property, Plant and Equipment and Inventory

## Property, plant and equipment

Property, plant and equipment is comprised of the following at September 30, 2016 and December 31, 2015 (in thousands):

	September	December
	30, 2016	31, 2015
Machinery and equipment	\$152,757	\$126,850
Office furniture, computers and software	12,813	8,771
Leasehold improvements	13,232	7,582
Buildings and land	43,008	31,856
	221,810	175,059
Less: accumulated depreciation	(76,363 )	(59,111 )
Total	\$145,447	\$115,948

Depreciation expense was \$7.3 million and \$19.5 million for the three and nine months ended September 30, 2016, and \$5.2 million and \$15.8 million for the three and nine months ended September 30, 2015.

## Inventory

Inventory is comprised of the following at September 30, 2016 and December 31, 2015 (in thousands):

	September	December
	30, 2016	31, 2015
Raw materials and supplies	\$26,022	\$23,604
Work-in-process	8,966	8,763
Finished goods <sup>(1)</sup>	204,910	31,196
Less: obsolescence reserve	(7,911 )	(3,658 )
Total	\$231,987	\$59,905

<sup>(1)</sup> Finished goods balance at September 30, 2016 includes \$37.6 million inventory step-up related to the preliminary purchase price allocation for 5.11 Tactical.

## Note H — 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 (primarily trade names). Goodwill represents the difference between purchase cost and the fair value of net assets acquired in business acquisitions. Indefinite lived intangible assets are not amortized unless their useful life is determined to be finite. Long-lived intangible assets are subject to amortization using the straight-line method. 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 represents a reporting unit, except Arnold, which comprises three reporting units.



Table of Contents

## Goodwill

## 2016 Annual goodwill 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 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. At March 31, 2016, we determined that the Tridien reporting unit (which is reported as a discontinued operations in the accompanying financial statements after the sale of the reporting unit in September 2016) required further quantitative testing (step 1) because we could not conclude that the fair value of the reporting unit exceeds its carrying value based on qualitative factors alone. Results of the step 1 quantitative testing of Tridien indicated that the fair value of Tridien exceeded its carrying value. For the reporting units that were tested qualitatively, the results of the qualitative analysis indicated that the fair value of those reporting units exceeded their carrying value.

## Arnold

Arnold has experienced declines in revenue and operating income during the first nine months of 2016 as compared to the prior year. The results at Arnold may continue to be lower than forecast and as a result, it may be necessary to perform interim Step 1 goodwill impairment testing at Arnold in the fourth quarter of 2016.

A summary of the net carrying value of goodwill at September 30, 2016 and December 31, 2015, is as follows (in thousands):

	Nine months ended September 30, 2016	Year ended December 31, 2015
Goodwill - gross carrying amount	485,054	390,655
Accumulated impairment losses	—	—
Goodwill - net carrying amount	\$ 485,054	\$ 390,655

The following is a reconciliation of the change in the carrying value of goodwill for the nine months ended September 30, 2016 by operating segment (in thousands):

	Corporate (1)	5.11	Ergobaby	Liberty	Manitoba Harvest	ACI	Arnold (2)	Clean Earth	Sterno	Total
Balance as of January 1, 2016	\$ 8,649	\$—	\$ 41,664	\$ 32,828	\$ 52,673	\$ 58,019	\$ 51,767	\$ 111,339	\$ 33,716	\$ 390,655
Acquisition of Northern International Inc.	—	—	—	—	—	—	—	—	5,980	5,980
Acquisition of Phoenix Soil <sup>(3)</sup>	—	—	—	—	—	—	—	3,212	—	3,212
Acquisition of EWS <sup>(3)</sup>	—	—	—	—	—	—	—	3,313	—	3,313
Acquisition of BabyTula <sup>(3)</sup>	—	—	13,193	—	—	—	—	—	—	13,193
Purchase adjustments - HOCI	—	—	—	—	(10,579 )	—	—	—	—	(10,579 )
Acquisition of 5.11 <sup>(3)</sup>	—	76,186	—	—	—	—	—	—	—	76,186

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Foreign currency translation	—	—	—	—	3,094	—	—	—	—	3,094
Balance as of Sept. 30, 2016	\$ 8,649	\$ 76,186	\$ 54,857	\$ 32,828	\$ 45,188	\$ 58,019	\$ 51,767	\$ 117,864	\$ 39,696	\$ 485,054

- (1) Represents goodwill resulting from purchase accounting adjustments not "pushed down" to the ACI segment. This amount is allocated back to the respective segment for purposes of goodwill impairment testing.
- (2) Arnold Magnetics has three reporting units PMAG, FlexMag and Precision Thin Metals with goodwill balances of \$40.4 million, \$4.8 million and \$6.5 million, respectively.
- (3) The goodwill related to the acquisitions of 5.11 Tactical, and the acquisitions of Phoenix Soil and EWS by Clean Earth and Baby Tula by Ergobaby is based on a preliminary purchase price allocation.

Table of Contents

## Long lived assets

## Orbitbaby

During the second quarter of 2016, Ergobaby's board of directors approved a plan to dispose of the Orbitbaby product line. Ergobaby determined at the time the plan was approved that the carrying value of the long lived assets associated with the Orbitbaby product line was not recoverable, and therefore, Ergobaby recorded a loss on disposal of assets of \$7.2 million related to the write off of the long-lived assets of Orbitbaby. The loss is comprised of the write-off of intangible assets of \$5.5 million, property, plant and equipment of \$0.4 million, other assets of \$1.0 million, and \$0.3 million in early lease termination costs. Ergobaby will continue to sell the remaining Orbitbaby inventory through the end of 2016.

## 2016 Annual indefinite lived impairment testing

The Company uses a qualitative approach to test indefinite lived intangible assets for impairment by first assessing qualitative factors to determine whether it is more-likely-than-not that the fair value of an indefinite lived intangible asset is impaired as a basis for determining whether it is necessary to perform quantitative impairment testing. The Company evaluated the qualitative factors of each reporting unit that maintains indefinite lived intangible assets in connection with the annual impairment testing for 2016. Results of the qualitative analysis indicate that the carrying value of the Company's indefinite lived intangible assets did not exceed their fair value.

Other intangible assets are comprised of the following at September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015	Weighted Average Useful Lives
Customer relationships	\$308,336	\$212,454	13
Technology and patents	51,953	38,230	9
Trade names, subject to amortization	129,007	25,003	15
Licensing and non-compete agreements	8,645	6,024	5
Permits and airspace	110,624	98,673	13
Distributor relations and other	606	606	5
	609,171	380,990	

## Accumulated amortization:

Customer relationships	(76,803 )	(62,679 )
Technology and patents	(23,393 )	(16,481 )
Trade names, subject to amortization	(6,053 )	(4,639 )
Licensing and non-compete agreements	(6,637 )	(5,913 )
Permits and airspace	(19,651 )	(12,313 )
Distributor relations and other	(606 )	(606 )
Total accumulated amortization	(133,143 )	(102,631 )
Trade names, not subject to amortization	72,986	72,328
Total intangibles, net	\$549,014	\$350,687

Amortization expense related to intangible assets was \$8.4 million and \$24.0 million for the three and nine months ended September 30, 2016, and \$7.3 million and \$21.5 million for the three and nine months ended September 30, 2015, respectively. Estimated charges to amortization expense of intangible assets over the next five years, is as follows (in thousands):

July 1, 2016 through Dec. 31, 2016	\$19,454
2017	43,542
2018	43,046
2019	42,162
2020	41,916

\$ 190,120

## Table of Contents

### Note I — Debt

#### 2014 Credit Facility

The 2014 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 Company amended the 2014 Credit Facility in June 2015, primarily to allow for intercompany loans to, and the acquisition of, Canadian-based companies on an unsecured basis, and to modify provisions that would allow for early termination of a "Leverage Increase Period," thereby providing additional flexibility as to the timing of subsequent acquisitions. On August 15, 2016, the Company amended the 2014 Credit Facility to, among other things, increase the aggregate amount of the 2014 Credit Facility by \$400 million. On August 31, 2016, the Company entered into an Incremental Facility Amendment to the 2014 Credit Agreement (the "Incremental Facility Amendment"). The Incremental Facility Amendment provided for an increase to the 2014 Revolving Credit Facility of \$150 million, and the 2016 Incremental Term Loan, in the amount of \$250 million. As a result of the Incremental Facility Amendment, the 2014 Credit Facility currently provides for (i) a revolving credit facility of \$550 million (as amended from time to time, the "2014 Revolving Credit Facility"), (ii) a \$325 million term loan (the "2014 Term Loan Facility"), and (iii) a \$250 million incremental term loan "the "2016 Incremental Term Loan").

#### 2014 Revolving Credit Facility

The 2014 Revolving Credit Facility will become due in June 2019. The Company can borrow, prepay and reborrow principal under the 2014 Revolving Credit Facility from time to time during its term. Advances under the 2014 Revolving Credit Facility can be either LIBOR rate loans or base rate loans. LIBOR rate revolving loans bear interest at a rate per annum equal to the London Interbank Offered Rate (the "LIBOR Rate") plus a margin ranging from 2.00% to 2.75% based on the ratio of consolidated net indebtedness to adjusted consolidated earnings before interest expense, tax expense and depreciation and amortization expenses (the "Consolidated Leverage Ratio"). Base rate revolving loans bear interest at a fluctuating rate per annum equal to the greatest of (i) the prime rate of interest, or (ii) the Federal Funds Rate plus 0.50% (the "Base Rate"), plus a margin ranging from 1.00% to 1.75% based upon the Consolidated Leverage Ratio.

#### Term Loans

##### 2014 Term Loan

The 2014 Term Loan Facility expires in June 2021 and requires quarterly payments that commenced September 30, 2014, with a final payment of all remaining principal and interest due on June 6, 2021. The 2014 Term Loan Facility was issued at an original issue discount of 99.5% of par value and bears interest at either the applicable LIBOR Rate plus 3.25% per annum, or Base Rate plus 2.25% per annum. The LIBOR Rate applicable to both base rate loans and LIBOR rate loans shall in no event be less than 1.00% at any time.

##### 2016 Incremental Term Loan

The 2016 Incremental Term Loan was issued at an original issue discount of 99.25% of par value. The Company incurred \$6.0 million in additional debt issuance costs related to the Incremental Credit Facility, which will be recognized as expense during the remaining term of the related 2014 Revolving Credit Facility, and 2014 Term Loan and 2016 Incremental Term Loan. The Incremental Facility Amendment did not change the due dates or applicable interest rates of the 2014 Credit Agreement. The quarterly payments for the term advances under the 2014 Credit

Agreement increased to approximately \$1.4 million per quarter. The Company used the proceeds from the Incremental Facility Amendment to fund the acquisition of 5.11 Tactical (refer to Note C - "Acquisitions").

The additional advances under the Incremental Credit Facility was a loan modification for accounting purposes. Consequently, the Company capitalized debt issuance costs of \$6.0 million associated with fees charged by lenders of the Incremental Credit Facility. The capitalized debt issuance costs will be amortized over the remaining period of the 2014 Credit Facility.

Table of Contents

## Other

The 2014 Credit Facility provides for sub-facilities under the 2014 Revolving Credit Facility pursuant to which 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 reduces the amount available under the 2014 Revolving Credit Facility. The Company will pay (i) commitment fees on the unused portion of the 2014 Revolving Credit Facility ranging from 0.45% to 0.60% per annum based on its Consolidated Leverage Ratio, (ii) quarterly letter of credit fees, and (iii) administrative and agency fees.

## Debt Issuance Costs

Deferred debt issuance costs represent the costs associated with the entering into the 2014 Credit Facility as well as the issuance costs associated with the August 2016 Incremental Facility Amendment and are amortized over the term of the related debt instrument. The Company's 2014 Credit Facility is comprised of the 2014 Revolving Credit Facility and the 2014 Term Loan Facility. Since the Company can borrow, repay and reborrow principal under the 2014 Revolving Credit Facility, the debt issuance costs associated with this facility have been classified as other non-current assets in the accompanying consolidated balance sheet. The debt issuance costs associated with the 2014 Term Loan are classified as a reduction of long-term debt in the accompanying consolidated balance sheet.

The following table summarizes debt issuance costs at September 30, 2016 and December 31, 2015, and the balance sheet classification in each of the periods presents (in thousands):

	September 30, December 31, 2016                      2015	
Deferred debt issuance costs	\$ 18,966	\$ 12,973
Accumulated amortization	(5,312      )	(3,508      )
Deferred debt issuance costs, less accumulated amortization	\$ 13,655	\$ 9,466
Balance Sheet classification:		
Other non-current assets	\$ 5,187	\$ 4,863
Long-term debt	8,468	4,603
	\$ 13,655	\$ 9,466

The following table provides the Company's debt holdings at September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Revolving Credit Facility	\$167,000	\$—
Term Loan	567,079	320,125
Original issue discount	(4,972      )	(3,633      )
Debt issuance costs - term loan	(8,468      )	(4,603      )
Total debt	\$720,639	\$311,889
Less: Current portion, term loan facilities	(5,685      )	(3,250      )
Long term debt	\$714,954	\$308,639

Net availability under the 2014 Revolving Credit Facility was approximately \$377.9 million at September 30, 2016. Letters of credit outstanding at September 30, 2016 totaled approximately \$5.1 million. At September 30, 2016, the Company was in compliance with all covenants as defined in the 2014 Credit Facility.

## Note J — Derivative Instruments and Hedging Activities

On September 16, 2014, the Company purchased an interest rate swap ("New Swap") with a notional amount of \$220 million. The New Swap is effective April 1, 2016 through June 6, 2021, the 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.



## Table of Contents

At September 30, 2016 and December 31, 2015, this Swap had a fair value loss of \$18.7 million and \$13.0 million, respectively, principally reflecting the present value of future payments and receipts under the agreement.

On October 31, 2011, the Company purchased a three-year interest rate swap (the "Swap") with a notional amount of \$200 million effective January 1, 2014 through March 31, 2016. The agreement requires the Company to pay interest on the notional amount at the rate of 2.49% in exchange for the three-month LIBOR rate, with a floor of 1.5%. At December 31, 2015, the Swap had a fair value loss of \$0.5 million. A final payment under the Swap of \$0.5 million was made on March 31, 2016 when the Swap contract ended.

The Company did not elect hedge accounting for the above derivative transactions and as a result, periodic mark-to-market changes in fair value are reflected as a component of interest expense in the consolidated statement of operations.

The following table reflects the classification of the Company's interest rate swaps on the consolidated balance sheets at September 30, 2016 and December 31, 2015 (in thousands):

	September 30, 2016	December 31, 2015
Other current liabilities	\$ 4,546	\$ 3,914
Other noncurrent liabilities	14,145	9,569
Total fair value	\$ 18,691	\$ 13,483

### Note K — Fair Value Measurement

The following table provides the assets and liabilities carried at fair value measured on a recurring basis at September 30, 2016 and December 31, 2015 (in thousands):

	Fair Value Measurements at September 30, 2016			
	Carrying Value	Level 1	Level 2	Level 3
Assets:				
Equity method investment - FOX	\$197,742	\$197,742	\$—	\$—
Liabilities:				
Put option of noncontrolling shareholder <sup>(1)</sup>	(50 )	—	—	(50 )
Put option of noncontrolling shareholders <sup>(2)</sup>	(50 )	—	—	(50 )
Contingent consideration - acquisitions <sup>(3)</sup>	(4,830 )	—	—	(4,830 )
Interest rate swap	(18,691 )	—	(18,691 )	—
Total recorded at fair value	\$174,121	\$197,742	\$(18,691)	\$(4,930)

<sup>(1)</sup> Represents a put option issued to a noncontrolling shareholder in connection with the 5.11 Tactical acquisition.

<sup>(2)</sup> Represents put options issued to noncontrolling shareholders in connection with the Liberty acquisition.

<sup>(3)</sup> Represents potential earn-outs payable by Sterno Products for the acquisition of NII and Ergobaby in connection with their acquisition of Baby Tula.

	Fair Value Measurements at December 31, 2015			
	Carrying Value	Level 1	Level 2	Level 3
Assets:				
Equity method investment - FOX	\$249,747	\$249,747	\$—	\$—
Liabilities:				
Put option of noncontrolling shareholders	(50 )	—	—	(50 )
Interest rate swaps	(13,483 )	—	(13,483 )	—
Total recorded at fair value	\$236,214	\$249,747	\$(13,483)	\$(50)



Table of Contents

Reconciliations of the change in the carrying value of the Level 3 fair value measurements from January 1, 2016 through September 30, 2016 are as follows (in thousands):

	2016
Balance at January 1st	\$(50 )
Contingent consideration - acquisition	(1,500 )
Balance at March 31st	\$(1,550)
Balance at June 30th	\$(1,550)
Contingent consideration acquisition	(3,780 )
Put option - noncontrolling shareholder	(50 )
Contingent consideration - payment	450
Balance at September 30th	\$(4,930)

## Valuation Techniques

## Contingent Consideration:

Sterno Products entered into a contingent consideration arrangement associated with the purchase of NII in January 2016. The earnout provision provides for payments up to \$1.8 million over a two year period subsequent to acquisition. Earnings before interest, taxes, depreciation and amortization ("EBITDA") is the performance target defined and measured to determine the earnout payment due, if any, after each defined measurement period. The contingent consideration was valued at \$1.5 million using probability weighted models. During the quarter ended September 30, 2016, Sterno paid \$0.5 million of the contingent consideration and determined that the remaining fair value of the liability was appropriate.

In connection with the acquisition of Baby Tula in May 2016, Ergobaby entered into a contingent consideration arrangement with the sellers. The earnout provision provides for additional consideration of \$8.2 million if the gross profit for Baby Tula for the 2017 fiscal year exceeds a specified level. No earnout amount will be paid if the specified gross profit level is not met. Ergobaby valued the contingent consideration at a fair value of \$3.8 million using a probability weighted option pricing model.

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, 2015.

## 2014 Term Loan

At September 30, 2016, the carrying value of the principal under the Company's outstanding Term Loans, including the current portion, was \$567.1 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 2014 Term Loan is based on quoted market prices for similar debt issues and is, therefore, classified as Level 2 in the fair value hierarchy.

## Nonrecurring Fair Value Measurements

The following table provides the assets carried at fair value measured on a non-recurring basis as of September 30, 2016.

(in thousands)	Fair Value Measurements at September 30, 2016			Expense
	Carrying Value	Level 1	Level 2	Level 3
				September 30, 2016

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Property, Plant and Equipment <sup>(1)</sup>	—	—	—	—	—375
Tradename <sup>(1)</sup>	—	—	—	—	—20
Technology <sup>(1)</sup>	—	—	—	—	—3,460
Customer relationships <sup>(1)</sup>	—	—	—	—	—2,007

30

---

Table of Contents

<sup>(1)</sup> Represents the fair value of the respective assets of the Orbitbaby product line. Refer to Note H "Goodwill and Other Intangible Assets" for a description of the loss on disposal of long-lived asset charge recognized during 2016.

Note L — Stockholders' Equity

Trust 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.

Profit Allocation Interests

The Allocation Interests represent the original equity interest in the Company. The holders of the Allocation Interests ("Holders") are entitled to receive distributions pursuant to a profit allocation formula upon the occurrence of certain events. The distributions of the profit allocation are paid upon the occurrence of the sale of a material amount of capital stock or assets of one of the Company's businesses ("Sale Event") or, at the option of the Holders, at each five year anniversary date of the acquisition of one of the Company's businesses ("Holding Event"). The Company records distributions of the profit allocation to the Holders upon occurrence of a Sale Event or Holding Event as distributions declared on Allocation Interests to stockholders' equity when they are approved by the Company's board of directors. The sale of FOX shares in March 2016 (refer to "Note F - Equity Method Investment") qualified as a Sale Event under the Company's LLC Agreement. As a result, in April 2016, in respect to the March Offering, the Company's board of directors approved and declared a profit allocation payment totaling \$8.6 million that was paid to Holders during the second quarter of 2016. In November 2016, in respect to the August Offering and the sale of Tridien, both qualifying as Sale Events, the Company's board of directors approved and declared a profit allocation payment of \$7.0 million which will be paid during the fourth quarter of 2016.

The Company's board of directors also declared and the Company paid an \$8.2 million distribution in the third quarter of 2016 to the Allocation Member in connection with a Holding Event of our ownership of the Advanced Circuits subsidiary. The payment is in respect to Advanced Circuits' positive contribution-based profit in the five year holding period ending June 30, 2016.

Earnings per share

The Company calculates basic and diluted earnings per share using the two-class method which requires the Company to allocate participating securities that have rights to earnings that otherwise would have been available only to Trust shareholders as a separate class of securities in calculating earnings per share. The Allocation Interests are considered participating securities that contain participating rights to receive profit allocations upon the occurrence of a Holding Event or Sale Event. The calculation of basic and diluted earnings per share for the three and nine months ended September 30, 2016 and 2015 reflects the incremental increase during the period in the profit allocation distribution to Holders related to Holding Events.

## Table of Contents

Basic and diluted earnings per share for the three and nine months ended September 30, 2016 and 2015 attributable to Holdings is calculated as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Income (loss) from continuing operations attributable to Holdings	\$47,862	\$8,737	\$50,198	\$3,146
Less: Profit Allocation paid to Holdings	8,196	—	16,829	—
Less: Effect of contribution based profit - Holding Event	812	883	1,292	2,837
Income (loss) from continuing operation attributable to Trust shares	\$38,854	\$7,854	\$32,077	\$309
Income from discontinued operations attributable to Holdings	\$1,843	\$155,763	\$2,723	\$160,909
Less: Effect of contribution based profit	—	27	—	—
Income from discontinued operations attributable to Trust shares	\$1,843	\$155,736	\$2,723	\$160,909
Basic and diluted weighted average shares outstanding	54,300	54,300	54,300	54,300
Basic and fully diluted income (loss) per share attributable to Holdings				
Continuing operations	\$0.72	\$0.14	\$0.59	\$0.01
Discontinued operations	0.03	2.87	0.05	2.96
	\$0.75	\$3.01	\$0.64	\$2.97

## Distributions

On January 28, 2016, the Company paid a distribution of \$0.36 per share to holders of record as of January 21, 2016. This distribution was declared on January 7, 2016.

- On April 28, 2016, the Company paid a distribution of \$0.36 per share to holders of record as of April 21, 2016. This distribution was declared on April 7, 2016.

On July 28, 2016, the Company paid a distribution of \$0.36 per share to holders of record as of July 21, 2016. This distribution was declared on July 7, 2016.

On October 27, 2016, the Company paid a distribution of \$0.36 per share to holders of record as of October 20, 2016. This distribution was declared on October 6, 2016.

## Note M — Warranties

The Company's Ergobaby and Liberty operating segments estimate their exposure to warranty claims based on both current and historical product sales data and warranty costs incurred. The Company assesses the adequacy of its recorded warranty liability quarterly and adjusts the amount as necessary. A reconciliation of the change in the carrying value of the Company's warranty liability for the nine months ended September 30, 2016 and the year ended December 31, 2015 is as follows (in thousands):

	Nine months ended September 30, 2016	Year ended December 31, 2015
Warranty liability:		
Beginning balance	\$ 1,258	\$ 1,262

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Accrual	267	344
Warranty payments (170	) (348	)
Ending balance	\$ 1,355	\$ 1,258

32

---

Table of Contents

## Note N — Noncontrolling Interest

Noncontrolling interest represents the portion of the Company's majority-owned subsidiary's net income (loss) and equity that is owned by noncontrolling shareholders. The following tables reflect the Company's ownership percentage of its majority owned operating segments and related noncontrolling interest balances as of September 30, 2016 and December 31, 2015:

	% Ownership <sup>(1)</sup>		% Ownership <sup>(1)</sup>	
	September 30, 2016		December 31, 2015	
	Primary	Fully Diluted	Primary	Fully Diluted
5.11 Tactical	97.5	97.5	N/a	N/a
Ergobaby	83.9	76.2	81.0	74.2
Liberty	88.6	84.7	96.2	84.6
Manitoba Harvest	76.6	66.7	76.6	65.6
ACI	69.4	69.3	69.4	69.3
Arnold Magnetics	96.7	84.7	96.7	87.3
Clean Earth	97.5	79.8	97.5	86.2
Sterno Products	100.0	89.7	100.0	89.7

(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.

	Noncontrolling Interest Balances	
(in thousands)	September 30, 2016	December 31, 2015
5.11 Tactical	5,640	—
Ergobaby	17,786	17,754
Liberty	2,498	2,934
Manitoba Harvest	13,677	14,071
ACI	(11,835 )	4,295
Arnold Magnetics	2,173	2,113
Clean Earth	5,072	4,308
Sterno Products	1,116	644
Allocation Interests	100	100
	\$36,227	\$ 46,219

## ACI Recapitalization

During the second quarter of 2016, the Company completed a recapitalization at ACI whereby the Company entered into an amendment to the intercompany debt agreement with ACI (the "ACI Loan Agreement"). The ACI loan agreement was amended to provide for additional term loan borrowings of \$61.0 million to fund a cash distribution to shareholders totaling \$60.1 million. Minority interest shareholders of Advanced Circuits, including certain members of management at Advanced Circuits, received total distribution proceeds of \$18.4 million. The Company used cash on hand to fund the distribution to minority shareholders.

## Liberty Recapitalization



During the first quarter of 2016, the Company completed a recapitalization at Liberty whereby the Company entered into an amendment to the intercompany loan agreement with Liberty (the “Liberty Loan Agreement”). The Liberty Loan Agreement was amended to (i) provide for term loan borrowings of \$38.0 million and revolving credit facility borrowings of \$5.0 million to fund cash distributions totaling \$35.3 million to its shareholders, including the Company, and (ii) extend the maturity dates of the term loans and revolving credit facility. Liberty’s noncontrolling shareholders received approximately \$5.3 million in distributions as a result of the recapitalization. Immediately prior to the recapitalization, management exercised stock options for 75,095 shares of Liberty common shares, resulting in net proceeds from stock options at Liberty of \$3.8 million. Liberty recognized \$0.3 million in compensation expense related to the accelerated vesting of a portion of management's stock options at the time of exercise. The Company then purchased \$1.5 million in Liberty common shares from members of Liberty management, resulting in Liberty's

## Table of Contents

noncontrolling shareholders holding 11.4% of Liberty's outstanding shares subsequent to the recapitalization. The purchase of the Liberty common stock from noncontrolling shareholders and issuance of Liberty common stock related to the exercise of stock options by noncontrolling shareholders were at fair value and resulted in no change in control of Liberty. The difference between the consideration paid for the noncontrolling interest and the adjustment to the carrying amount of the Company's noncontrolling interest in Liberty was recognized in the Company's equity. Subsequent to the purchase of Liberty common shares and the exercise of the options, the Company owns 88.6% of Liberty on a primary basis and 84.7% on a fully diluted basis.

### Ergobaby Share Issuance

In connection with the Ergobaby acquisition of Baby Tula in May 2016, Ergobaby issued shares of their stock valued at \$8.2 million to the selling shareholders (refer to Note C - Acquisitions for the methodology used to determine the value of the shares at issuance). Subsequent to the issuance of the shares, the noncontrolling interest in Ergobaby was 77.9% on a primary basis and 71.2% on a fully diluted basis.

### Ergobaby Share Repurchase

In June 2016, Ergobaby repurchased 77,425 shares of Ergobaby common stock from certain noncontrolling interest shareholders for a total purchase price of \$15.4 million. Ergobaby financed the repurchase of shares with an increase to the intercompany debt facility with the Company. The difference between the consideration paid for the noncontrolling interest and the adjustment to the carrying amount of the Company's noncontrolling interest in Ergobaby was recognized in the Company's equity. Subsequent to the repurchase, the noncontrolling interest in Ergobaby is 83.9% on a primary basis and 76.2% on a fully diluted basis. The repurchased shares have been accounted for as treasury shares by Ergobaby.

### Note O — 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.

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. Pursuant to U.S. tax laws, earnings from those jurisdictions will be subject to the U.S. income tax rate when those earnings are repatriated. During the quarter ending September 30, 2016, management changed the previously asserted tax position that Arnold planned to permanently re-invest foreign earnings of controlled foreign corporations. The principal reason for changing our position is managements' plan to repatriate excess foreign cash at Arnold to pay down the inter-company debt with the Company. A deferred tax liability of \$2.8 million related to Arnold's foreign subsidiaries was recorded as a result of the change in position pursuant to APB 23.

The reconciliation between the Federal Statutory Rate and the effective income tax rate for the nine months ended September 30, 2016 and 2015 are as follows:

	Nine months ended September 30,	
	2016	2015
United States Federal Statutory Rate	35.0 %	35.0 %
State income taxes (net of Federal benefits)	0.2	7.6
Foreign income taxes	1.4	(6.0 )
	6.3	41.7

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

Expenses of Compass Group Diversified Holdings, LLC representing a pass through to shareholders  
(1)

Effect of (gain) loss on equity method investment <sup>(2)</sup>	(33.3)	(20.4)
Impact of subsidiary employee stock options	0.7	1.0
Domestic production activities deduction	(0.6 )	(3.7 )
Effect of undistributed foreign earnings	4.5	—
Non-recognition of NOL carryforwards at subsidiaries	—	(0.1 )
Other	1.6	1.2
Effective income tax rate	15.8 %	56.3 %

34

---

Table of Contents

- (1) The effective income tax rate for the nine months ended September 30, 2016 and 2015 includes a significant loss at the Company's parent, which is taxed as a partnership.
- (2) The equity method investment in FOX is held at the Company's parent, which is taxed as a partnership, resulting in the gain or loss on the investment as a reconciling item in deriving the effective tax rate.

Note P — 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 \$4.6 million is recognized in the consolidated balance sheet as a component of other non-current liabilities at September 30, 2016. Net periodic benefit cost consists of the following for the three and nine months ended September 30, 2016 and 2015 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Service cost	\$111	\$121	\$325	\$455
Interest cost	35	34	103	132
Expected return on plan assets	5	(282 )	15	(416 )
Effect of curtailment	—	37	—	(864 )
Net periodic benefit cost	\$151	\$(90 )	\$443	\$(693 )

During the first half of 2016, Arnold recognized an increase in the unfunded pension liability primarily as a result of a decrease in the discount rate used to measure the pension benefit obligation. The discount rate decreased from 1.00% at December 31, 2015 to 0.15% at September 30, 2016, resulting in an increase to the pension benefit obligation at September 30, 2016.

During the three and nine months ended September 30, 2016, per the terms of the pension agreement, Arnold contributed \$0.1 million and \$0.3 million, respectively, to the plan. For the remainder of 2016, the expected contribution to the plan will be approximately \$0.1 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 September 30, 2016 were considered Level 3.

Note Q - Commitments and Contingencies

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

Note R - Subsequent Events

Allocation Interests - Profit Allocation Payment

The sale of FOX shares in the August Offering and the sale of Tridien in September 2016 qualified as Sale Events under the Company's LLC Agreement. During the fourth quarter, the Company's board of directors declared a distribution to the Allocation Member in connection with the FOX Sale Event. Under the terms of the LLC

Agreement, the loss on the sale of Tridien is an offset against the gain on the sale of FOX shares. The result is a net distribution to the Allocation Member of \$7.0 million. The profit allocation payment will be made during the quarter ended December 31, 2016.

## Table of Contents

### 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 sections entitled "Forward-Looking Statements" included elsewhere in this Quarterly Report 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, 2015 and Item 1A. Risk Factors in Part II of this quarterly report.

#### Overview

Compass Diversified Holdings, a Delaware statutory trust ("Holdings" or the "Trust"), was incorporated in Delaware on November 18, 2005. Compass Group Diversified Holdings, LLC, a Delaware limited liability Company (the "Company"), was also formed on November 18, 2005. The Trust and the Company (collectively "CODI") were formed to acquire and manage a group of small and middle-market businesses headquartered in North America. The Trust is the sole owner of 100% of the Trust Interests, as defined in our LLC Agreement, of the Company. Pursuant to the LLC Agreement, the Trust owns an identical number of Trust Interests in the Company as exist for the number of outstanding shares of the Trust. Accordingly, our shareholders are treated as beneficial owners of Trust Interests in the Company and, as such, are subject to tax under partnership income tax provisions. The Company is the operating entity with a board of directors whose corporate governance responsibilities are similar to that of a Delaware corporation. The Company's board of directors oversees the management of the Company and our businesses and the performance of Compass Group Management LLC ("CGM" or our "Manager"). Certain persons who are employees and partners of our Manager receive a profit allocation as owners of 58.8% of the Allocation Interests in us, as defined in our LLC Agreement.

The Trust and the Company were formed to acquire and manage a group of small and middle-market businesses headquartered in North America. We characterize small to middle market businesses as those that generate annual cash flows of up to \$60 million. We focus on companies of this size because of our belief that these companies are often more able to achieve growth rates above those of their relevant industries and are also frequently more susceptible to efforts to improve earnings and cash flow.

In pursuing new acquisitions, we seek businesses with the following characteristics:

- North American base of operations;
- stable and growing earnings and cash flow;
- maintains a significant market share in defensible industry niche (i.e., has a "reason to exist");
- solid and proven management team with meaningful incentives;
- low technological and/or product obsolescence risk; and
- a diversified customer and supplier base.

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.

We are dependent on the earnings of, and cash receipts from our businesses to meet our corporate overhead and management fee expenses and to pay distributions. These earnings and distributions, net of any minority interests in these businesses, are generally available:

first, to meet capital expenditure requirements, management fees and corporate overhead expenses;  
second, to fund distributions from the businesses to the Company; and  
third, to be distributed by the Trust to shareholders.

## Table of Contents

### Recent Events

#### Acquisition of 5.11 Tactical

On August 31, 2016, we closed on the acquisition of 5.11 Tactical, a designer and marketer of purpose-built tactical apparel and gear serving a wide range of global customers including law enforcement, military special operations and fire fighters, as well as outdoor enthusiasts. The purchase price for 5.11, net of transaction costs of \$2.1 million, was \$405.1 million. We funded the acquisition through an Incremental Facility Amendment to the 2014 Credit Agreement. The Incremental Facility Amendment provided an increase to the 2014 Revolving Credit Facility of \$150.0 million, and an advance under the 2016 Incremental Term Loan in the amount of \$250.0 million.

#### Disposition of Tridien Medical

On September 21, 2016, a subsidiary of Hill-Rom Holdings, Inc. acquired our Tridien subsidiary, based on an enterprise value of \$25 million. After the allocation of the sales price to non-controlling equity holders and the payment of transaction expenses, the Company received approximately \$21 million in net proceeds at closing. We recognized a gain of \$1.5 million on the sale of Tridien during the quarter ended September 30, 2016.

#### Partial Divestiture of FOX shares

On August 12, 2016, FOX, closed on a secondary public offering of 4,025,000 shares held by certain FOX shareholders, including the Company. The Company sold a total of 3,500,000 shares of FOX common stock in this offering, for total net proceeds of \$63.0 million. Upon completion of the offering, our ownership of FOX decreased from approximately 33% to approximately 23%, which is our ownership level currently. This sale of the portion of our FOX shares in August 2016 qualified as a Sale Event under the Company's LLC Agreement. Our board of directors declared a distribution to the Holders of the Allocation Interests of \$11.6 million in connection with the Sale Event of FOX in August 2016. The profit allocation payment will be made during the quarter ended December 31, 2016.

During the first quarter of 2016, FOX closed on a secondary public offering of 2,500,000 shares of FOX common shares held by the Company. Concurrently with the closing of the offering, FOX repurchased 500,000 shares of FOX common stock held by the Company. As a result of the sale of shares through the offering and the repurchase of shares by FOX, we sold a total of 3,000,000 shares of FOX common stock, with total net proceeds of approximately \$47.7 million. Upon completion of the offering and repurchase of shares by FOX, our ownership interest in FOX was reduced from approximately 41% to 33%. This sale of the portion of our FOX shares in March 2016 qualified as a Sale Event under the Company's LLC Agreement. During the second quarter, our board of directors declared a distribution to the Holders of the Allocation Interests of \$8.6 million in connection with the Sale Event of FOX. The profit allocation payment was made during the quarter ended June 30, 2016.

#### Acquisition of Baby Tula

On May 11, 2016, the Company's Erbobaby subsidiary, acquired all of the outstanding membership interests in New Baby Tula LLC ("Baby Tula"), a maker of premium baby carriers, toddler carriers, slings, blankets and wraps. The purchase price was \$73.8 million, net of transaction costs, plus a potential earn-out of \$8.2 million based on 2017 financial performance. Ergobaby paid \$0.8 million in transaction costs in connection with the acquisition. Ergobaby funded the acquisition and payment of related transaction costs through the issuance of an additional \$68.2 million in inter-company loans with the Company, and the issuance of \$8.2 million in Ergobaby shares to the selling shareholders.

#### Acquisitions of EWS and Phoenix Soil

On June 1, 2016, the Company's Clean Earth subsidiary acquired certain of the assets and liabilities of EWS Alabama, Inc. ("EWS"). Clean Earth funded the acquisition and the related transaction costs through the issuance of additional inter-company debt with the Company. Based in Glencoe, Alabama, EWS provides a range of hazardous and non-hazardous waste management services from a fully permitted hazardous waste RCRA Part B facility.

On April 15, 2016, Clean Earth acquired certain assets and liabilities of Phoenix Soil, LLC ("Phoenix Soil") and WIC, LLC (together with Phoenix Soil, the "Sellers"). Clean Earth funded the acquisition and the related transaction costs through the issuance of additional inter-company debt with the Company. Phoenix Soil is based in Plainville, CT and provides environmental services for nonhazardous contaminated soil materials with a primary focus on soil. Phoenix Soil recently completed its transition to a new 58,000 square foot thermal desorption facility owned by WIC, LLC.



The acquisition increased Clean Earth's soil treatment capabilities and expand its geographic footprint into New England.

## Table of Contents

### Acquisition of Northern International Inc.

On January 22, 2016, Sterno Products, a wholly owned subsidiary of the company, acquired all of the outstanding stock of Northern International, Inc. (NII), for a purchase price of approximately \$35.8 million (C\$50.6 million). The purchase price includes an earn-out payable over two years of up to a maximum amount of \$1.8 million (C\$2.5 million), and is subject to working capital adjustments. Headquartered in Coquitlam, British Columbia, Canada, NII sells flameless candles and outdoor lighting products through the retail segment. Sterno Products financed the acquisition and payment of the related transaction costs through the issuance of an additional \$37.0 million in inter-company loans with the Company.

### Ergobaby Share Repurchase

In June 2016, Ergobaby repurchased 77,425 shares of Ergobaby common stock from certain noncontrolling interest shareholders for a total purchase price of \$15.4 million. Ergobaby financed the repurchase of shares with an increase to the intercompany debt facility with the Company. Subsequent to the repurchase, the noncontrolling interest in Ergobaby is 83.9% on a primary basis and 76.2% on a fully diluted basis. The shares have been accounted for as treasury shares by Ergobaby.

### 2016 Outlook

We remain focused on marketing the Company's attractive ownership and management attributes to potential sellers of middle market businesses and intermediaries. In addition, we continue to pursue opportunities for add-on acquisitions by certain of our existing subsidiary companies, which can be particularly attractive from a strategic perspective. We completed an add-on acquisition at our Sterno Products subsidiary in the first quarter of 2016, and additional add-on acquisitions at our Clean Earth and Ergobaby subsidiaries in the second quarter.

### Discontinued Operations

The results of operations for CamelBak and American Furniture for the three and nine months ended September 30, 2015 are presented as discontinued operations in our consolidated financial statements as a result of the sale of these operating segments in August and October 2015, respectively. The results of operations for Tridien for the three and nine months ended September 30, 2016 and 2015 are presented as discontinued operations in our consolidated financial statements as a result of the sale of Tridien in September 2016. See Note D - "Discontinued Operations", to our consolidated financial statements for further discussion of the operating results of our discontinued businesses.

### Non-GAAP Financial Measures

U.S. GAAP refers to generally accepted accounting principles in the United States. A non-GAAP financial measure is a numerical measure of historical or future performance, financial position or cash flow that excludes amounts, or is subject to adjustments that effectively exclude amounts, included in the most directly comparable measure calculated and presented in accordance with GAAP in our financial statements, and vice versa for measures that include amounts, or are subject to adjustments that effectively include amounts, that are excluded from the most directly comparable measure as calculated and presented. Our Manitoba Harvest acquisition uses the Canadian Dollar as its functional currency. We will periodically refer to net sales and net sales growth rates in the Manitoba Harvest management's discussion and analysis on a "constant currency" basis so that the business results can be viewed without the impact of fluctuations in foreign currency exchange rates, thereby facilitating period-to-period comparisons of Manitoba Harvest's business performance. "Constant currency" net sales results are calculated by translating current period net sales in local currency using the prior year's currency conversion rate. Generally, when the dollar either strengthens or weakens against other currencies, the growth at constant currency rates or adjusting for currency will be higher or lower than growth reported at actual exchange rates. "Constant currency" measured net sales is not a measure of net sales presented in accordance with U.S. GAAP.

### Results of Operations

We were formed on November 18, 2005 and acquired our existing businesses (segments) at September 30, 2016 as follows:

Edgar Filing: Compass Diversified Holdings - Form 10-Q

May 16, 2006	March 31, 2010	September 16, 2010	March 5, 2012
Advanced Circuits	Liberty Safe	Ergobaby	Arnold Magnetics
August 26, 2014	October 10, 2014	July 10, 2015	August 31, 2016
Clean Earth	Sterno Products	Manitoba Harvest	5.11 Tactical

38

---

Table of Contents

In the following results of operations, we provide (i) our actual consolidated results of operations for the three and nine months ended September 30, 2016 and 2015, which includes the historical results of operations of our businesses (operating segments) from the date of acquisition and (ii) comparative results of operations for each of our businesses on a stand-alone basis for the three and nine months ended September 30, 2016 and 2015.

## Consolidated Results of Operations – Compass Diversified Holdings and Compass Group Diversified Holdings LLC

	Three months ended September 30, 2016		Nine months ended September 30, 2015	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
(in thousands)				
Net sales	\$252,285	\$184,830	\$659,748	\$528,447
Cost of sales	169,870	120,260	436,544	355,489
Gross profit	82,415	64,570	223,204	172,958
Selling, general and administrative expense	53,648	36,310	140,702	98,385
Fees to manager	8,435	6,373	21,394	19,597
Amortization of intangibles	8,423	7,259	23,966	21,455
Loss on disposal of assets	551	—	7,214	—
Operating income	\$11,358	\$14,628	\$29,928	\$33,521

## Three months ended September 30, 2016 compared to three months ended September 30, 2015

## Net sales

On a consolidated basis, net sales for the three months ended September 30, 2016 increased by approximately \$67.5 million or 36.5% compared to the corresponding period in 2015. Our acquisition of 5.11 Tactical on August 31, 2016 contributed \$27.2 million to the increase in net sales. During the three months ended September 30, 2016 compared to 2015, we also saw notable sales increases at Ergobaby (\$7.7 million, primarily due to the acquisition of Baby Tula in May 2016), Manitoba Harvest (\$7.1 million, primarily due to the acquisition of HOIC in December 2015), Clean Earth (\$7.4 million) and Sterno (\$23.9 million, primarily due to the acquisition of NII in January 2016), offset by a decrease in sales at Arnold Magnetics (\$5.7 million). Refer to "Results of Operations - Our Businesses" for a more detailed analysis of net sales 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 sales

On a consolidated basis, cost of sales increased approximately \$49.6 million during the three month period ended September 30, 2016, compared to the corresponding period in 2015. 5.11 Tactical accounted for \$20.2 million of the increase in cost of sales during the three months ended September 30, 2016, Clean Earth accounted for \$8.2 million of the increase, Manitoba Harvest accounted for \$4.6 million of the increase, and Sterno's acquisition, NII, accounted for \$16.9 million of the increase. These increases were offset by decreases in cost of sales at other operating segments, particularly Arnold (\$4.1 million). Gross profit as a percentage of sales was approximately 32.7% in the three months ended September 30, 2016 compared to 34.9% in 2015. Refer to "Results of Operations - Our Businesses" for a more detailed analysis of cost of sales by business segment.

Selling, general and administrative expense

On a consolidated basis, selling, general and administrative expense increased approximately \$17.3 million during the three month period ended September 30, 2016, compared to the corresponding period in 2015. The increase in expenses in the 2016 quarter compared to 2015 is principally the result of the 5.11 Tactical acquisition in August 2016 (\$8.7 million), and the effect of our add-on acquisitions during the quarter. Refer to "Results of Operations - Our Businesses" for a more detailed analysis of selling, general and administrative

## Table of Contents

expense by business segment. At the corporate level, general and administrative expense were \$2.7 million in the third quarter of 2016 and \$2.1 million in the three months ended September 30, 2015.

### Fees to manager

Pursuant to the Management Services Agreement, we pay CGM a quarterly management fee equal to 0.5% (2.0% annually) of our consolidated adjusted net assets. We accrue for the management fee on a quarterly basis. For the three months ended September 30, 2016, we incurred approximately \$8.4 million in management fees as compared to \$6.4 million in fees in the three months ended September 30, 2015. The increase in the management fees that occurred is a result of the increase in consolidated net assets resulting from the add-on acquisitions completed during the first half of 2016, and the acquisition of 5.11 Tactical in the third quarter of 2016.

### Loss on disposal of assets

Ergobaby recorded a \$0.6 million loss on disposal of assets during the third quarter of 2016 related to its decision to dispose of the Orbitbaby product line. Refer to the Ergobaby section for additional details regarding the loss on disposal.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

### Net sales

On a consolidated basis, net sales for the nine months ended September 30, 2016 increased by approximately \$131.3 million or 24.8% compared to the corresponding period in 2015. Our acquisition of 5.11 Tactical on August 31, 2016 contributed \$27.2 million to the increase in net sales. During the nine months ended September 30, 2016 compared to 2015, we also saw notable sales increases at Ergobaby (\$10.9 million, primarily due to the acquisition of Baby Tula), Manitoba Harvest (\$12.2 million, primarily due to the acquisition of HOCI in December 2015), Clean Earth (\$11.1 million, primarily due to the acquisitions of EWS and Phoenix Soil) and Sterno (\$58.0 million, primarily due to the acquisition of NII in January 2016), offset by decreases in sales at Advanced Circuits (\$1.8 million), and Arnold Magnetics (\$10.3 million). Refer to "Results of Operations - Our Businesses" for a more detailed analysis of net sales 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 sales

On a consolidated basis, cost of sales increased approximately \$81.1 million during the nine month period ended September 30, 2016, compared to the corresponding period in 2015. The acquisition of 5.11 Tactical accounted for \$20.2 million of the increase in cost of sales during the nine months ended September 30, 2016, Ergobaby contributed \$6.8 million to the increase (primarily due to the Baby Tula acquisition), Manitoba Harvest contributed \$8.8 million to the increase (primarily due to the acquisition of HOCI) and Sterno's acquisition, NII, accounted for \$42.3 million of the increase. These increases were offset by decreases in cost of sales at other operating segments, particularly Arnold (\$8.1 million). Gross profit as a percentage of sales was approximately 33.8% in the nine months ended September 30, 2016 compared to 32.7% in 2015. Refer to "Results of Operations - Our Businesses" for a more detailed analysis of cost of sales by business segment.

Selling, general and administrative expense

On a consolidated basis, selling, general and administrative expense increased approximately \$42.3 million during the nine month period ended September 30, 2016, compared to the corresponding period in 2015. The increase in expenses in 2016 compared to 2015 is principally the result of the 5.11 Tactical acquisition in August 2016 (\$8.7 million), and Sterno Products' acquisition of NII in January 2016. Refer to "Results of Operations - Our Businesses" for a more detailed analysis of selling, general and administrative expense by business segment. At the corporate level, general and administrative expense increased from \$7.5 million in the nine months ended September 30, 2015 to \$8.6 million in the nine months ended September 30, 2016.

Fees to manager

Pursuant to the Management Services Agreement, we pay CGM a quarterly management fee equal to 0.5% (2.0% annually) of our consolidated adjusted net assets. We accrue for the management fee on a quarterly basis. For the nine months ended September 30, 2016, we incurred approximately \$21.4 million in expense for these fees compared to \$19.6 million for the corresponding period in

Table of Contents

2015. The increase in the management fees that occurred is a result of the increase in consolidated net assets resulting from the add-on acquisitions completed during the first half of 2016, and the acquisition of 5.11 Tactical in the third quarter of 2016.

### Loss on disposal of assets

Ergobaby recorded a \$7.2 million loss on disposal of assets during the nine months ended September 30, 2016 related to its decision to dispose of the Orbitbaby product line. Refer to the Ergobaby section for additional details regarding the loss on disposal.

### Results of Operations — Our Businesses

We categorize the businesses we own into two separate groups of businesses (i) branded products businesses and, (ii) niche industrial businesses. Branded products 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 products businesses are leaders in their particular category. Niche industrial businesses are characterized as those businesses that focus on manufacturing, servicing and selling particular products within a specific market sector. We believe that our niche industrial businesses are leaders in their specific market sector.

The following discussion reflects a comparison of the historical results of operations of each of our businesses for the three and nine month periods ending September 30, 2016 and September 30, 2015 on a stand-alone basis. For the 2015 acquisition of Manitoba Harvest, the following discussion reflects pro forma results of operations for the three and nine months ended September 30, 2015 as if we had acquired Manitoba Harvest on January 1, 2015. For the 5.11 Tactical acquisition, the following discussion reflects pro forma results of operations for the three and nine months ended September 30, 2016 and 2015 as if we had acquired 5.11 on January 1, 2015. 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.

### Branded Products Businesses

#### 5.11 Tactical

##### Overview

5.11 Tactical is a leading provider of purpose-built tactical apparel and gear crafted 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.

We made loans to and purchased a controlling interest in 5.11 Tactical for \$407.1 million in August 2016, representing approximately 97.5% of the initial outstanding equity of 5.11 ABR Corp.

##### Results of Operations

The table below summarizes the income from operations data for 5.11 Tactical on a proforma basis for the three and nine months ended September 30, 2016 and 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(Pro forma)		(Pro forma)	
Net sales	\$74,655	\$ 86,173	\$212,667	\$ 215,269



Edgar Filing: Compass Diversified Holdings - Form 10-Q

Cost of sales <sup>(1)</sup>	46,797	48,791	123,857	123,329
Gross profit	27,858	37,382	88,810	91,940
Selling, general and administrative expense <sup>(2)</sup>	25,954	25,023	78,998	71,864
Fees to manager <sup>(3)</sup>	250	250	750	750
Amortization of intangibles <sup>(4)</sup>	2,047	2,047	6,140	6,140
Income (loss) from operations	(393	) 10,062	2,922	13,186

41

---

## Table of Contents

Pro forma results of operations of 5.11 Tactical for the three and nine months ended September 30, 2016 and 2015 include the following pro forma adjustments, applied to historical results as if we had acquired 5.11 on January 1, 2015:

- (1) Pro forma cost of sales for the three and nine months ended September 30, 2016 prior to acquisition does not include \$42.3 million of expense associated with the inventory fair value step-up recorded in 2016 as a result of the preliminary purchase price allocation for 5.11 Tactical. Subsequent to the acquisition, the step-up in inventory value will increase cost of goods sold over approximately nine months as the inventory is sold. \$4.7 million was expensed in September 30, 2016 in the actual results of 5.11 subsequent to acquisition.
- (2) Selling, general and administrative expenses were increased by approximately \$0.7 and \$2.0 million in the three and nine months ended September 30, 2016 and 2015, respectively, as a result of stock compensation expense related to stock options that will be granted to 5.11 employees as a result of the acquisition.
- (3) Represents management fees that would have been payable to the Manager in each of the periods presented.
- (4) Represents amortization of intangible assets in the three and nine month periods ended September 2016 and 2015, respectively, for amortization expense associated with the allocation of the fair value of intangible assets resulting from the preliminary purchase price allocation in connection with our acquisition.

Pro forma three months ended September 30, 2016 compared to the pro forma three months ended September 30, 2015

### Net sales

Net sales for the three months ended September 30, 2016 were \$74.7 million as compared to net sales of \$86.2 million for the three months ended September 30, 2015, a decrease of \$11.5 million, or 13.4%. This decrease is due primarily to a large direct-to-agency order of approximately \$13.5 million that shipped in August 2015, which did not repeat during the three months ended September 30, 2016. Base revenues, which are considered all revenues outside of direct-to-agency business, decreased 4% over the comparable period. This decrease was primarily driven by timing differences of shipments between quarters. This decrease was partially offset by strength in retail and e-commerce revenues which grew 123% and 26%, respectively. Retail revenues grew due to four new store openings since September of 2015 (bringing the total store count to eight as of September 30, 2016).

### Cost of sales

Cost of sales for the three months ended September 30, 2016 were \$46.8 million as compared to \$48.8 million for the comparable period in 2015, a decrease of \$2.0 million. Gross profit as a percentage of sales was 37.3% in the three months ended September 30, 2016 as compared to 43.4% in the three months ended September 30, 2015. Cost of sales for the three months ended September 30, 2016 also includes \$4.7 million in expense related to a \$42.3 million inventory step-up resulting from the preliminary acquisition purchase price allocation. The total inventory step-up amount of \$42.3 million will be expensed to cost of goods sold over the expected turns of 5.11's inventory. The remaining amount of the change in gross profit percentage (30 bps increase in gross profit as a percentage of sales) was due to slightly lower discounts and promotional activity as compared to the prior period and a larger proportion of revenues from the higher margin retail and e-commerce distribution channels as compared to the prior period.

### Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2016 was \$26.0 million, or 34.8% of net sales compared to \$25.0 million, or 29.0% for the comparable period in 2015. This increase in selling, general and administrative expense was primarily due to increases in employee related costs and retail stores that were not open in the prior comparable period. Selling, general and administrative expenses were a larger percentage of net sales for the three months ended September 30, 2016 due to a lower revenue base as compared to the prior year period during which a large direct-to-agency order occurred in August 2015.

### Income (loss) from operations

Loss from operations for the three months ended September 30, 2016 was \$0.4 million, a decrease of \$10.5 million when compared to income from operations of \$10.1 million for the same period in 2015, based on the factors described above.



## Table of Contents

Pro forma nine months ended September 30, 2016 compared to pro forma nine months ended September 30, 2015

### Net sales

Net sales for the nine months ended September 30, 2016 were \$212.7 million, a decrease of \$2.6 million, or 1.2%, compared to the same period in 2015. The decrease in net sales is due primarily to a large direct-to-agency order of approximately \$13.5 million which shipped in August 2015, which did not repeat during the nine months ended September 30, 2016. Base revenues, which are considered all revenues outside of direct-to-agency business increased 5% over the comparable period. This increase was driven primarily by strength in retail and e-commerce revenues which grew 131% and 20%, respectively. Retail revenues grew due to five new store openings since January of 2015 (bringing the total store count to eight as of September 30, 2016), and a comparable store sales increase of 23%. In addition, sales increased 11% in the consumer wholesale channel due to strong sell-through in the outdoor and sporting goods accounts.

### Cost of sales

Cost of sales for the nine months ended September 30, 2016 were \$123.9 million compared to \$123.3 million for the nine months ended September 30, 2015. Gross profit as a percentage of sales decreased from 42.7% in the nine months ended September 30, 2015 to 41.8% in the nine months ended September 30, 2016. Cost of sales for the nine months ended September 30, 2016 includes \$4.7 million in expense related to a \$42.3 million inventory step-up resulting from the acquisition purchase price allocation. The total inventory step-up amount of \$42.3 million will be expensed to cost of goods sold over the expected turns of 5.11x inventory. The gross profit as a percentage of sales increased 120 bps after eliminating the effect of the inventory step up expense. This increase was due to lower discounts and promotional activity and a larger proportion of revenues from the higher margin retail and e-commerce distribution channels as compared to the prior year period. During the nine months ended September 30, 2015, the Company incurred unusually high levels of discounts and promotional activity caused by the West Coast Port slowdown. These discounts and promotional activity did not recur in the nine months ended September 30, 2016.

### Selling, general and administrative expenses

Selling, general and administrative expenses for the nine months ended September 30, 2016 increased to \$79.0 million or 37.1% of net sales compared to \$71.9 million or 33.4% of net sales in the same period in 2015. This increase in selling, general and administrative expenses was primarily attributable to increases in employee related costs including wage increases and slightly increased staffing levels. In addition, the increase is due to five new retail stores that were not open in the prior year comparable period. Selling, general and administrative expenses were a larger percentage of net sales for the nine months ended September 30, 2016 due to a lower revenue base as compared to the prior year period during which a large direct-to-agency order occurred in August 2015.

### Income from operations

Income from operations for the nine months ended September 30, 2016 was \$2.9 million, a decrease of \$10.3 million when compared to the same period in 2015, based on the factors noted above.

### Ergobaby

#### Overview

Ergobaby, headquartered in Los Angeles, California, is a premier designer, marketer and distributor of wearable baby carriers and related baby wearing products, as well as infant travel systems consisting of strollers, car seats and accessories. Ergobaby offers a broad range of wearable baby carriers, infant travel systems and related products that are sold through more than 450 retailers and web shops in the United States and throughout the world. Ergobaby has two main product lines: baby carriers (baby carriers and accessories) and infant travel systems (strollers, car seats and accessories).

We made loans to and purchased a controlling interest in Ergobaby on September 16, 2010, for approximately \$85.2 million, representing approximately 84% of the equity in Ergobaby.

On November 18, 2011, Ergobaby acquired all the outstanding stock of Orbitbaby for \$17.5 million. Orbitbaby produces and markets a premium line of infant travel systems. Orbitbaby's high-quality products include stroller frames, seats, car seats and bassinets that are interchangeable using a patented hub ring. During the second quarter of 2016, Ergobaby's board of directors approved a plan to dispose of the Orbitbaby product line.

Table of Contents

On May 12, 2016, Ergobaby acquired membership interests of New Baby Tula LLC (“Baby Tula”) for approximately \$73.8 million, excluding a potential earn-out payment. Baby Tula designs, markets and distributes baby carriers and accessories. The results of operations of Baby Tula are included from the date of acquisition through September 30, 2016.

**Results of Operations**

The table below summarizes the income from operations data for Ergobaby for the three and nine months ended September 30, 2016 and September 30, 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$29,664	\$ 21,944	\$75,048	\$ 64,104
Cost of sales	13,818	7,866	29,169	22,369
Gross profit	15,846	14,078	45,879	41,735
Selling, general and administrative expense	9,947	7,602	27,489	22,686
Fees to manager	125	125	375	375
Amortization of intangibles	552	634	1,700	1,910
Loss on disposal of assets	551	—	7,214	—
Income from operations	\$4,671	\$ 5,717	\$9,101	\$ 16,764

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

**Net sales**

Net sales for the three months ended September 30, 2016 were \$29.7 million, an increase of \$7.7 million or 35.2% compared to the same period in 2015. Net sales from Baby Tula for the third quarter were \$5.8 million. During the three months ended September 30, 2016, international sales were approximately \$16.7 million, representing an increase of \$3.9 million over the corresponding period in 2015. International sales from Baby Tula for the third quarter were \$2.1 million. International sales of baby carriers and accessories, including Baby Tula, increased by approximately \$4.4 million and international sales of infant travel systems decreased by approximately \$0.5 million during the quarter ended September 30, 2016 as compared to the comparable quarter in 2015. Domestic sales were \$12.9 million in the third quarter of 2016, reflecting an increase of \$3.8 million compared to the corresponding period in 2015. The increase in domestic sales was due to a \$4.9 million increase in sales of baby carrier and accessories and a \$1.1 million decrease in domestic sales of infant travel systems and accessories. Baby Tula sales represent an increase of \$3.6 million in domestic baby carrier and accessories sales. The decrease in infant travel systems and accessories sales was primarily attributable to lower demand of travel systems and the decision to exit the Orbit Baby brand. Baby carriers and accessories represented 94.7% of sales in the three months ended September 30, 2016 compared to 85.4% in the same period in 2015.

**Cost of sales**

Cost of sales was approximately \$13.8 million for the three months ended September 30, 2016, as compared to \$7.9 million for the three months ended September 30, 2015, an increase of \$6.0 million. Cost of sales for Baby Tula were approximately \$5.4 million, and includes \$3.7 million in expense associated with the inventory step-up recorded in connection with the purchase price allocation for Baby Tula. The increase in cost of sales was primarily attributable to higher sales compared to the prior period. Gross profit as a percentage of sales was 53.4% for the quarter ended September 30, 2016 compared to 64.2% for the same period in 2015. Excluding the impact of the inventory step-up expense on cost of sales, gross profit as a percentage of sales was 65.9% for the three months ended September 30, 2016.

Selling, general and administrative expenses

Selling, general and administrative expense for the three months ended September 30, 2016 increased to approximately \$9.9 million or 33.5% of net sales compared to \$7.6 million or 34.6% of net sales for the same period of 2015. The \$2.3 million increase in the three months ended September 30, 2016 compared to the same period in 2015 was primarily attributable to the increases in employee related costs due to increased staffing levels, increases in professional fees, and higher distribution and fulfillment and commissions due to the increase in domestic sales.

## Table of Contents

### Loss on disposal of assets

Ergobaby recorded a \$0.6 million loss on disposal of assets during the third quarter of 2016 related to its decision in the second quarter to dispose of the Orbitbaby product line. In October 2016, Ergobaby sold a majority of the Orbit Baby intellectual property and tooling assets. The proceeds of the sale will reduce the loss recorded on disposal of assets by approximately \$1.0 million in the fourth quarter of 2016.

### Income from operations

Income from operations for the three months ended September 30, 2016 decreased \$1.0 million, to \$4.7 million, compared to \$5.7 million for the same period of 2015, primarily due to the loss on disposal of assets.

### Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

#### Net sales

Net sales for the nine months ended September 30, 2016 were \$75.0 million, an increase of \$10.9 million or 17.1% compared to the same period in 2015. Net sales for Baby Tula subsequent to acquisition were \$10.6 million. During the nine months ended September 30, 2016, international sales were approximately \$40.7 million, representing an increase of \$4.6 million over the corresponding period in 2015. International sales of baby carriers and accessories increased by approximately \$6.4 million and international sales of infant travel systems decreased by approximately \$1.3 million during the nine months ended September 30, 2016 as compared to the comparable nine month period in 2015. Baby Tula international sales represent an increase of \$3.5 million. During the nine months ended September 30, 2016, Ergobaby moved to a direct sales model from a distributor model in Canada and the United Kingdom, which negatively impacted the international sales comparison. Domestic sales were \$34.4 million during the nine months ended September 30, 2016, reflecting an increase of \$6.3 million compared to the corresponding period in 2015. Domestic sales of baby carriers and accessories increased \$7.9 million and domestic sales of infant travel systems and accessories decreased \$2.1 million during the nine months ended September 30, 2016 compared to the same period in 2015. Baby Tula domestic sales represent an increase of \$7.0 million. The decrease in domestic infant travel systems and accessories was primarily attributable to lower demand of travel systems and the decision to exit the Orbit Baby brand. Baby carriers and accessories represented 92.3% of sales in the nine months ended September 30, 2016 compared to 85.7% in the same period in 2015.

#### Cost of sales

Cost of sales was approximately \$29.2 million for the nine months ended September 30, 2016, as compared to \$22.4 million for the nine months ended September 30, 2015, an increase of \$6.8 million. Cost of sales for Baby Tula were approximately \$6.6 million, and includes \$3.7 million in expense associated with the inventory step-up recorded in connection with the purchase price allocation for Baby Tula. The increase in cost of sales was primarily attributable to higher sales compared to the prior period. Gross profit as a percentage of sales was 61.1% for the nine months ended September 30, 2016 compared to 65.1% for the same period in 2015. Excluding the impact of the inventory step-up expense on cost of sales, gross profit as a percentage of sales was 66.1% for the nine months ended September 30, 2016.

#### Selling, general and administrative expenses

Selling, general and administrative expense for the nine months ended September 30, 2016 increased to approximately \$27.5 million or 36.6% of net sales compared to \$22.7 million or 35.4% of net sales for the same period of 2015. The \$4.8 million increase in the nine months ended September 30, 2016 compared to the same period in 2015 was primarily attributable to the acquisition costs and additional selling, general and administrative expenses related to Baby Tula, and to higher marketing spend, increases in employee related costs due to increased staffing levels, partially offset by decreased variable expenses, such as distribution and fulfillment and commissions, due to the decrease in domestic travel system sales.



Loss on disposal of assets

Ergobaby recorded a \$7.2 million loss on disposal of assets during the nine months ended September 30, 2016 related to its decision to dispose of the Orbitbaby product line. The loss is comprised of the write-off of intangible assets of \$5.5 million, property, plant and equipment of \$0.4 million, and other assets of \$1.0 million. Ergobaby recorded additional expense of \$0.6 million in the third quarter of 2016, primarily related to the early termination of the Orbitbaby lease. In October 2016, Ergobaby sold a majority of the Orbit Baby intellectual property and tooling assets. The proceeds of the sale will reduce the loss recorded on disposal of assets by approximately \$1.0 million in the fourth quarter of 2016.

Table of Contents

## Income from operations

Income from operations for the nine months ended September 30, 2016 decreased \$7.7 million, to \$9.1 million, compared to \$16.8 million for the same period of 2015, primarily as a result of the loss on disposal of assets.

## Liberty Safe

## Overview

Based in Payson, Utah and founded in 1988, Liberty Safe is the premier designer, manufacturer and marketer of home and gun safes in North America. From its over 314,000 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 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. Historically, approximately 55% of Liberty Safe's net sales are Non-Dealer sales and 45% are Dealer sales.

We made loans to and purchased a controlling interest in Liberty Safe for approximately \$70.2 million in March 2010, representing approximately 96% of the equity in Liberty.

## Results of Operations

The table below summarizes the income from operations data for Liberty Safe for the three and nine months ended September 30, 2016 and September 30, 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$23,810	\$ 23,404	\$74,713	\$ 74,013
Cost of sales	17,680	16,207	53,197	54,462
Gross profit	6,130	7,197	21,516	19,551
Selling, general and administrative expense	3,332	3,263	10,483	9,955
Fees to manager	125	125	375	375
Amortization of intangibles	256	264	779	1,508
Income from operations	\$2,417	\$ 3,545	\$9,879	\$ 7,713

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

## Net sales

Net sales for the quarter ended September 30, 2016 increased approximately \$0.4 million or 1.7%, to \$23.8 million, compared to the corresponding quarter ended September 30, 2015. Non-Dealer sales were approximately \$11.9 million in the three months ended September 30, 2016 compared to \$12.5 million for the three months ended September 30, 2015, representing a decrease of \$0.6 million or 5.0%. Dealer sales totaled approximately \$11.9 million in the three months ended September 30, 2016 compared to \$10.9 million in the same period in 2015, representing an increase of \$1.0 million or 9.2%. The decrease in third quarter 2016 sales for the non-dealer channel is primarily attributable to a reduction in shipments to a couple of key customers. The increase in sales in the dealer channel can be attributed to strong overall consumer demand as well as growth in the handgun vault business.

## Cost of sales

Cost of sales for the three months ended September 30, 2016 increased approximately \$1.5 million when compared to the same period in 2015. Gross profit as a percentage of net sales totaled approximately 25.7% and 30.8% for the quarters ended September 30, 2016 and September 30, 2015, respectively. The decrease in gross profit as a percentage of sales during the three months ended September 30, 2016 compared to the same period in 2015 is primarily attributable to more promotional activity during third quarter of 2016 designed to drive additional sales, and a reduction of favorable overhead variances in 2016 as compared to 2015 due to more units produced in the third quarter of 2015 than in 2016. Liberty expects the favorable material pricing advantage related to steel to return to more normal levels beginning in the fourth quarter of 2016.

Table of Contents

Selling, general and administrative expense

Selling, general and administrative expense was \$3.3 million for both the three months ended September 30, 2016 and the three months ended September 30, 2015, representing 14.0% of net sales in 2016 and 13.9% of net sales for the same period of 2015.

Income from operations

Income from operations decreased \$1.1 million during the three months ended September 30, 2016 to \$2.4 million, principally as a result of the decrease in sales and gross profit, as described above.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

Net sales

Net sales for the nine months ended September 30, 2016 increased approximately \$0.7 million or 0.9%, to \$74.7 million, compared to the corresponding nine months ended September 30, 2015. Non-Dealer sales were approximately \$36.4 million in the nine months ended September 30, 2016 compared to \$40.0 million for the nine months ended September 30, 2015, representing a decrease of \$3.6 million or 9.1%. Dealer sales totaled approximately \$38.3 million in the nine months ended September 30, 2016 compared to \$34.0 million in the same period in 2015, representing an increase of \$4.3 million or 12.7%. The increase in sales is attributable to strong overall market demand during the first and third quarters of 2016 and Liberty's increased ability to meet that demand, particularly in the first quarter, and growth in the handgun vault business.

Cost of sales

Cost of sales for the nine months ended September 30, 2016 decreased approximately \$1.3 million when compared to the same period in 2015. Gross profit as a percentage of net sales totaled approximately 28.8% and 26.4% for the nine months ended September 30, 2016 and September 30, 2015, respectively. The increase in gross profit as a percentage of sales during the nine months ended September 30, 2016 compared to the same period in 2015 is attributable to favorable cost variances as a result of improved manufacturing efficiencies due to greater volume output, and favorable material costs related to the cost of steel, which is Liberty's primary raw material. Liberty expects to see the favorable material pricing advantage related to steel returning to more normal levels beginning in the fourth quarter of 2016.

Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2016 increased to approximately \$10.5 million or 14.0% of net sales compared to \$10.0 million or 13.5% of net sales for the same period of 2015. The \$0.5 million increase during the nine months ended September 30, 2016 is primarily attributable to increased spending on radio and other advertising media, higher sales commission expense, and additional expenses related to accelerated vesting of employee stock options and legal fees associated with the recapitalization of Liberty in March 2016.

Amortization of intangibles

Amortization expense in the first nine months of 2016 decreased \$0.7 million because certain intangible assets that resulted from the purchase of Liberty in March 2010 are now fully amortized.

Income from operations

Income from operations increased \$2.2 million during the nine months ended September 30, 2016 to \$9.9 million, compared to \$7.7 million during the same period in 2015, principally as a result of the increase in sales and gross profit, and decrease in amortization expense, as described above.

## Manitoba Harvest

### Overview

Headquartered in Winnipeg, Manitoba, Manitoba Harvest is a pioneer and leader in branded, hemp-based foods. Manitoba Harvest's products, which Management believes are the fastest growing in the hemp food market and among the fastest growing in the natural foods industry, are currently carried in approximately 7,000 retail stores across the U.S. and Canada. Manitoba Harvest's hemp-exclusive, consumer-facing 100% all-natural product lineup includes hemp hearts, protein powder, hemp oil and snacks.

Table of Contents

We made loans to and purchased a controlling interest in Manitoba Harvest for approximately \$102.7 million in July 2015 representing approximately 87% of the equity in Manitoba Harvest. On December 15, 2015, Manitoba Harvest acquired all of the outstanding stock of Hemp Oil Canada, Inc. ("HOCI") for approximately \$30.8 million. HOCI is a wholesale supplier and a private label packager of hemp food products and ingredients.

## Results of Operations

The table below summarizes the income from operations data for Manitoba Harvest for the three and nine months ended September 30, 2016 and the pro forma income from operations for the three and nine months ended September 30, 2015. The results of operations for HOCI are included subsequent to acquisition and are not included in the proforma 2015 presentation.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015 (Pro forma)	September 30, 2016	September 30, 2015 (Pro forma)
Net sales	\$15,920	\$9,341	\$44,321	\$32,069
Cost of sales <sup>(1)</sup>	8,988	4,414	24,442	15,645
Gross profit	6,932	4,927	19,879	16,424
Selling, general and administrative expense <sup>(2)</sup>	5,072	5,531	17,075	14,389
Fees to manager <sup>(3)</sup>	88	88	261	263
Amortization of intangibles <sup>(4)</sup>	1,218	889	3,408	2,771
Income (loss) from operations	\$554	\$(1,581)	\$(865)	\$(999)

Pro forma results of operations of Manitoba Harvest for the three and nine months ended September 30, 2015 include the following pro forma adjustments, applied to historical results as if we acquired Manitoba Harvest January 1, 2015:

- (1) Cost of sales for the three and nine months ended September 30, 2015 does not include \$3.1 million of expense associated with the inventory fair value step-up recorded in 2015 as a result of our purchase price allocation for Manitoba Harvest.
- (2) Selling, general and administrative expenses were increased by approximately \$0.3 million and \$0.6 million in the three and nine months ended September 30, 2015 as a result of stock compensation expense related to stock options granted to Manitoba Harvest employees as of the date of acquisition.
- (3) Represents management fees that would have been payable to the Manager in each of the periods presented.
- (4) Represents an increase in amortization of intangible assets totaling approximately \$1.1 million and \$2.2 million in the three and nine months ended months ended September 30, 2015, respectively, for additional amortization expense associated with the step up in fair value of intangible assets resulting from the purchase price allocation in connection with our acquisition.

Three months ended September 30, 2016 compared to pro forma three months ended September 30, 2015

Net sales

Net sales for the three months ended September 30, 2016 were approximately \$15.9 million as compared to \$9.3 million for the three months ended September 30, 2015, an increase of \$6.6 million, or 70.4%. Net sales of HOCI for the three months ended September 30, 2016 were \$5.1 million. Manitoba Harvest on a stand alone basis had a increase in net sales of \$1.5 million, due to higher demand in United States and international club sales from 2015 to 2016, and an increase in conventional hemp hearts demand partially offset by the lack of availability of organic based hemp hearts supply to meet demand levels.

#### Cost of sales

Cost of sales for the three months ended September 30, 2016 was approximately \$9.0 million compared to approximately \$4.4 million for the same period in 2015. Cost of sales for HOCI were \$3.2 million. Gross profit as a percentage of sales was 43.5% in the quarter ended September 30, 2016 and 52.7% in the quarter ended September 30, 2015. The decrease in gross profit percentage is primarily as a result of the gross margins at HOCI, which are historically lower since HOCI is a wholesale provider

## Table of Contents

of ingredients, as well as an increase in discounts and promotional expense at Manitoba Harvest in 2016, and additional expenses for slow moving inventory in 2016.

### Selling, general and administrative expense

Selling, general and administrative expenses for the three months ended September 30, 2016 decreased to approximately \$5.1 million or 31.9% of net sales compared to \$5.5 million or 59.2% of net sales for the same period in 2015. The \$0.5 million decrease in the three months ended September 30, 2016 compared to the same period in 2015 was primarily due to higher expenses incurred in 2015 related to the acquisition of Manitoba Harvest, partially offset by additional selling and administrative expenses attributable to HOCI (\$0.6 million) in 2016.

### Income (loss) from operations

Income from operations for the three months ended September 30, 2016 was approximately \$0.6 million, an increase of \$2.1 million when compared to the same period in 2015, based on the factors described above.

Nine months ended September 30, 2016 compared to pro forma nine months ended September 30, 2015

### Net sales

Net sales for the nine months ended September 30, 2016 were approximately \$44.3 million as compared to \$32.1 million for the nine months ended September 30, 2015, an increase of \$12.3 million, or 38.2%. Net sales of HOCI for the nine months ended September 30, 2016 were \$15.1 million. Manitoba Harvest on a stand alone basis had a decrease in net sales of \$2.9 million, or \$1.1 million on a constant currency basis, primarily due to a shift in product sales mix, increases in sales discounts and promotion expenses, the lack of availability of organic hemp seed in 2016, and a decrease in private label sales for the first quarter of 2016 versus the comparable prior year period. In the first quarter of 2015, one of Manitoba Harvest's private label customers expanded distribution into additional stores, resulting in a higher level of private label sales versus the current period.

### Cost of sales

Cost of sales for the nine months ended September 30, 2016 was approximately \$24.4 million compared to approximately \$15.6 million for the same period in 2015. Cost of sales for HOCI were \$9.4 million. Gross profit as a percentage of sales was 44.9% in the nine months ended September 30, 2016 and 51.2% in the nine months ended September 30, 2015, a decrease of 630 basis points, primarily as a result of the gross margins at HOCI, which are historically lower since HOCI is a wholesale provider of ingredients. After removing the effect of HOCI from gross margins, Manitoba Harvest's gross margin decreased from 51.7% on a pro forma basis for the first nine months of 2015 to 50.7% for the first nine months of 2016, primarily as a result of the lack of availability of organic hemp seed, which has higher gross margins, and additional reserves recorded for slow moving inventory and discounts and promotions expense in the current year as compared to 2015.

### Selling, general and administrative expense

Selling, general and administrative expenses for the nine months ended September 30, 2016 increased to approximately \$17.1 million or 38.5% of net sales compared to \$14.4 million or 44.9% of net sales for the same period in 2015. The \$2.7 million increase in the nine months ended September 30, 2016 compared to the same period in 2015 was primarily due to additional selling and administrative expenses attributable to HOCI (\$1.7 million), increases in employee related costs due to increased headcount, and higher expenses to support retail advertising, product demonstrations, marketing expenditures, as well as costs associated with the integration of HOCI post-acquisition.

### Loss from operations

Loss from operations for the nine months ended September 30, 2016 was approximately \$0.9 million, compared to loss from operations of \$1.0 million in the same period in 2015, based on the factors described above.

### Niche Industrial Businesses



## Advanced Circuits

### Overview

Advanced Circuits is a provider of small-run, quick-turn and volume production PCBs to customers throughout the United States. Historically, small-run and quick-turn PCBs have represented approximately 54% of Advanced Circuits' gross revenues. 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

## Table of Contents

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.

We purchased a controlling interest in Advanced Circuits on May 16, 2006.

### Results of Operations

The table below summarizes the income from operations data for Advanced Circuits for the three and nine month periods ended September 30, 2016 and September 30, 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$21,679	\$ 22,234	\$64,945	\$ 66,734
Cost of sales	12,066	12,228	36,024	36,609
Gross profit	9,613	10,006	28,921	30,125
Selling, general and administrative expense	3,417	3,335	10,370	10,207
Fees to manager	125	125	375	375
Amortization of intangibles	312	251	935	761
Income from operations	\$5,759	\$ 6,295	\$17,241	\$ 18,782

### Three months ended September 30, 2016 compared to the three months ended September 30, 2015

#### Net sales

Net sales for the three months ended September 30, 2016 decreased approximately \$0.6 million to \$21.7 million as compared to the three months ended September 30, 2015. The decrease in net sales was due to decreased gross sales in Long-Lead Time PCBs of \$1.0 million and a decrease in gross sales of Quick-Turn Small-Run and Quick-Turn Production PCBs of \$0.1 million, offset by increases of \$0.3 million in gross sales from Assembly and \$0.2 million in Subcontract gross sales. Sales from Quick-Turn Small-Run and Quick-Turn Production PCBs represented approximately 54.0% of gross sales in the third quarter of 2016 as compared to approximately 53.1% of gross sales in the third quarter of 2015.

#### Cost of sales

Cost of sales for the three months ended September 30, 2016 decreased approximately \$0.2 million as compared to the three months ended September 30, 2015. Gross profit as a percentage of sales decreased 70 basis points during the three months ended September 30, 2016 compared to the prior period (44.3% at September 30, 2016 compared to 45.0% at September 30, 2015) primarily as a result of sales mix.

#### Selling, general and administrative expense

Selling, general and administrative expenses were approximately \$3.4 million in the three months ended September 30, 2016 and \$3.3 million in the three months ended September 30, 2015. Selling, general and administrative expenses represented 15.8% of net sales for the three months ended September 30, 2016 compared to 15.0% of net sales in the prior year period.

#### Income from operations

Income from operations for the three months ended September 30, 2016 was approximately \$5.8 million compared to \$6.3 million in the same period in 2015, a decrease of approximately \$0.5 million, principally as a result of the factors described above.

### Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

#### Net sales

Net sales for the nine months ended September 30, 2016 decreased approximately \$1.8 million to \$64.9 million as compared to the nine months ended September 30, 2015. During the nine months ended September 30, 2016, gross sales in Long-Lead Time PCBs decreased by \$3.5 million and gross sales in Quick-Turn Small-Run and Quick-Turn Production PCBs decreased by \$0.6 million, offset by increases of \$2.0 million in gross sales from Assembly and \$0.4 million from Subcontract. Sales from Quick-Turn Small-Run and Quick-Turn Production PCBs represented approximately 53.6% of gross sales in the first nine months of 2016 compared to 53.1% during the same period of 2015.

## Table of Contents

### Cost of sales

Cost of sales for the nine months ended September 30, 2016 decreased approximately \$0.6 million compared to the nine months ended September 30, 2015. Gross profit as a percentage of sales decreased 60 basis points during the nine months ended September 30, 2016 compared to the same period in 2015 (44.5% at September 30, 2016 compared to 45.1% at September 30, 2015) primarily as a result of sales mix.

### Selling, general and administrative expense

Selling, general and administrative expenses were approximately \$10.4 million in the nine months ended September 30, 2016 as compared to \$10.2 million in the nine months ended September 30, 2015. Selling, general and administrative expenses represented 16.0% of net sales for the nine months ended September 30, 2016 compared to 15.3% of net sales in the prior year period.

### Income from operations

Income from operations for the nine months ended September 30, 2016 was approximately \$17.2 million compared to \$18.8 million in the same period in 2015, a decrease of approximately \$1.54 million, principally as a result of the factors described above.

### Arnold Magnetics

#### Overview

Founded in 1895 and headquartered in Rochester, New York, Arnold Magnetics is a manufacturer of engineered, application specific, permanent magnets. Arnold products are critical components in general industrial assemblies, reprographic systems, aerospace and defense, advertising and promotional, consumer and appliance, energy, automotive and medical technology. Arnold is the largest U.S. manufacturer of engineered magnets as well as only one of two domestic producers to design, engineer and manufacture rare earth magnetic solutions. Arnold operates a 70,000 sq. ft. manufacturing assembly and distribution facility in Rochester, New York with nine additional facilities worldwide, including sites in the United Kingdom, Switzerland and China. Arnold serves customers via three primary product sectors:

- Permanent Magnet and Assemblies and Reprographics (PMAG) (historically approximately 70% of net sales) - High performance magnets for precision motor/generator sensors as well as beam focusing and reprographics applications;
- Flexmag (historically approximately 20% of net sales) - Flexible bonded magnetic materials for advertising, consumer and industrial applications; and
- Precision Thin Metals (PTM) (historically approximately 10% of net sales) - Ultra thin metal foil products utilizing magnetic and non- magnetic alloys.

On March 5, 2012, we made loans to and purchased a controlling interest in Arnold for approximately \$128.8 million, representing 96.6% of the equity in Arnold Magnetics.

#### Results of Operations

The table below summarizes the income from operations data for Arnold Magnetics for the three and nine month periods ended September 30, 2016 and September 30, 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$26,912	\$ 32,590	\$82,791	\$ 93,138
Cost of sales	20,520	24,648	63,829	71,944
Gross profit	6,392	7,942	18,962	21,194
Selling, general and administrative expense	4,535	3,878	12,117	11,645
Fees to manager	125	125	375	375

Edgar Filing: Compass Diversified Holdings - Form 10-Q

Amortization of intangibles	881	881	2,642	2,642
Income from operations	\$851	\$ 3,058	\$3,828	\$ 6,532

51

---

Table of Contents

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

Net sales

Net sales for the three months ended September 30, 2016 were approximately \$26.9 million, a decrease of \$5.7 million compared to the same period in 2015. The decrease in net sales is primarily result of decreases in all product sectors. The decrease in the PMAG (\$4.8 million) product sector is primarily due to a non-recurring sale in September 2015 and lower customer demand. Decreases in the Flexmag (\$0.7 million) and PTM (\$0.2 million) product sectors are primarily due to lower customer demand.

International sales were \$12.2 million during the three months ended September 30, 2016 and \$10.8 million in the three months ended September 30, 2015.

Cost of sales

Cost of sales for the three months ended September 30, 2016 were approximately \$20.5 million compared to approximately \$24.6 million in the same period of 2015. Gross profit as a percentage of sales decreased from 24.4% for the quarter ended September 30, 2015 to 23.8% in the quarter ended September 30, 2016 principally due to currency movement.

Selling, general and administrative expense

Selling, general and administrative expense in the three month period ended September 30, 2016 was \$4.5 million as compared to approximately \$3.9 million for the three months ended September 30, 2015. The increase in expense is predominantly the result of severance pay in connection with changes in executive management.

Income from operations

Income from operations for the three months ended September 30, 2016 was approximately \$0.9 million, a decrease of \$2.2 million when compared to the same period in 2015, principally as a result of the factors previously mentioned.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

Net sales

Net sales for the nine months ended September 30, 2016 were approximately \$82.8 million, a decrease of \$10.3 million compared to the same period in 2015. The decrease in net sales is a result of decreases in the PMAG (\$7.4 million), Precision Thin Metals (\$1.8 million) and Flexmag (\$1.1 million) product sectors. PMAG sales represented 72% of net sales for the nine months ended September 30, 2016, compared to 71% for the nine months ended September 30, 2015. The decrease in PMAG sales is mainly attributable to weakness in the oil and gas sector and lower sales of reprographic products. The decrease in Precision Thin Metals and Flexmag sales during the nine months ended September 30, 2016 compared to the same period in 2015 is largely due to decreased customer demand.

International sales were \$33.7 million during the nine months ended September 30, 2016 compared to \$33.8 million during the same period in 2015, a decrease of \$0.2 million or 0.5%. The decrease in international sales is due to a decrease in sales in the PMAG sector as a result of weaker economic conditions in Europe, primarily in the oil and gas sector.

Cost of sales

Cost of sales for the nine months ended September 30, 2016 were approximately \$63.8 million compared to approximately \$71.9 million in the same period of 2015. Gross profit as a percentage of sales remained stable, increasing slightly from 22.8% for the nine months ended September 30, 2015 to 22.9% in the nine months ended September 30, 2016.

Selling, general and administrative expense

Selling, general and administrative expense in the six month period ended September 30, 2016 was \$12.1 million as compared to approximately \$11.6 million for the nine months ended September 30, 2015. The increase in expense is primarily attributable to severance related to changes within management.

Income from operations

Income from operations for the nine months ended September 30, 2016 was approximately \$3.8 million, a decrease of \$2.7 million when compared to the same period in the prior year, principally as a result of the factors previously discussed above.

Table of Contents

## Clean Earth

## Overview

Founded in 1990 and headquartered in Hatboro, Pennsylvania, Clean Earth is a provider of environmental services for a variety of contaminated materials. Clean Earth provides a one-stop shop solution that analyzes, treats, documents and recycles waste streams generated in multiple end-markets such as power, construction, commercial development, oil and gas, infrastructure, industrial and dredging. Historically, the majority of Clean Earth's revenues have been generated by contaminated soils which includes environmentally impacted soils, drill cuttings and other materials which are treated at one of its nine permitted soil treatment facilities. Clean Earth also operates four RCRA Part B hazardous waste facilities. The remaining revenue has been generated by dredge material, which consists of sediment removed from the floor of a body of water for navigational purposes and/or environmental remediation of contaminated waterways and is treated at one of its two permitted dredge processing facilities. Approximately 98% of the material processed by Clean Earth is beneficially reused for such purposes as daily landfill cover, industrial and brownfield redevelopment projects.

On August 26, 2014, we made loans to and purchased a controlling interest in Clean Earth for approximately \$251.4 million, representing approximately 98% of the equity in Clean Earth. Clean Earth completed two add-on acquisitions during the second quarter of 2016, Phoenix Soil and EWS. The results of operations for the add-on acquisitions have been included in Clean Earth's results from the date of acquisition through the end of the reporting period.

## Results of Operations

The table below summarizes the income from operations data for Clean Earth for the three and nine month periods ended September 30, 2016 and September 30, 2015.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Service revenues	\$51,515	\$ 44,092	\$ 134,035	\$ 122,923
Cost of services	36,863	28,671	95,967	88,430
Gross profit	14,652	15,421	38,068	34,493
Selling, general and administrative expense	7,352	7,457	22,263	19,905
Fees to manager	125	125	375	375
Amortization of intangibles	3,582	2,946	9,570	9,280
Income from operations	\$3,593	\$ 4,893	\$5,860	\$4,933

Three months ended September 30, 2016 compared to the three months ended September 30, 2015.

## Service revenues

Service revenues for the three months ended September 30, 2016 were approximately \$51.5 million, an increase of \$7.4 million or 16.8% compared to the same period in 2015. The increase in service revenues is due to an increase in contaminated soil and hazardous waste revenues as a result of new acquisitions and an increase in dredge volume due to an increase in bidding activity.

For the three months ended September 30, 2016, contaminated soil revenue increased 4% as compared to the same period last year principally attributable to project timing as well as from a recent acquisition. Hazardous waste



revenues increased 49% principally as a result of increased drum and aerosol can volume as well as volume from a recent acquisition. Revenue from dredged material increased for the three months ended September 30, 2016 as compared to the same period in 2015 due to project timing. Contaminated soils represented approximately 55% of net sales for the three months ended September 30, 2016 compared to 62% for the three months ended September 30, 2015.

## Table of Contents

### Cost of services

Cost of services for the three months ended September 30, 2016 were approximately \$36.9 million compared to approximately \$28.7 million in the same period of 2015. Gross profit as a percentage of sales decreased from 35.0% for the three month period ended September 30, 2015 to 28.4% for the same period ended September 30, 2016. The increase in gross margin during the three months ended September 30, 2016 was primarily due to higher back-end costs at some of our soil facilities.

### Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2016 decreased to approximately \$7.4 million or 14.3% of service revenues, as compared to \$7.5 million or 16.9% of service revenues for the same period in 2015.

### Income from operations

Income from operations for the three months ended September 30, 2016 was approximately \$3.6 million as compared to income from operations of \$4.9 million for the three months ended September 30, 2015, a decrease of \$1.3 million, primarily as a result of those factors described above.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

### Service revenues

Service revenues for the nine months ended September 30, 2016 were approximately \$134.0 million, an increase of \$11.1 million or 9.0% compared to the same period in 2015. The increase in service revenues is principally due to two acquisitions in 2016 and transportation revenue on projects where Clean Earth schedules the transportation. Transportation revenue has very low margins and is generally a pass-through to the customer.

For the nine months ended September 30, 2016, contaminated soil revenue increased 3% as compared to the same period last year principally attributable to increased commercial development activity in the Northeast. Hazardous waste revenues increased 22% principally as a result of increased drum and aerosol can volume as well as revenue from a recent acquisition. Revenue from dredged material increased 8% for the nine months ended September 30, 2016 as compared to the same period in 2015 due to the project timing. Contaminated soils represented approximately 58% of net sales for the nine months ended September 30, 2016 compared to 61% for the nine months ended September 30, 2015.

### Cost of services

Cost of services for the nine months ended September 30, 2016 were approximately \$96.0 million compared to approximately \$88.4 million in the same period of 2015. Gross profit as a percentage of sales increased from 28.1% for the nine month period ended September 30, 2015 to 28.4% for the same period ended September 30, 2016. The increase in gross margin during the nine months ended September 30, 2016 was primarily due to increased pricing across hazardous waste volumes.

### Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2016 increased to approximately \$22.3 million or 16.6% of service revenues, as compared to \$19.9 million or 16.2% of service revenues for the same period in 2015. The \$2.4 million increase in selling, general and administrative expenses in the three months ended September 30, 2016 compared to 2015 is primarily attributable to the reclassification of certain labor costs from cost of services to selling, general and administrative expenses, as well as a slight increase in labor costs and increased expenses associated with new acquisitions.

### Amortization expense

Amortization expense for the nine months ended September 30, 2016 was \$9.6 million, an increase of \$0.3 million compared to the nine months ended September 30, 2015.

Income from operations

Income from operations for the nine months ended September 30, 2016 was approximately \$5.9 million, an increase of \$0.9 million as compared to the nine months ended September 30, 2015, primarily as a result of those factors described above.

Table of ContentsSterno Products  
Overview

Sterno Products, headquartered in Corona, California, is a manufacturer and marketer of portable food warming fuel and creative table lighting solutions for the food service industry. Sterno Products offers a broad range of wick and gel chafing fuels, butane stoves and accessories, liquid and traditional wax candles, catering equipment and lamps. Sterno Products was formed in 2012 with the merger of two manufacturers and marketers of portable food warming fuel products, The Sterno Group LLC and the Candle Lamp Company, LLC.

On October 10, 2014, we made loans to and purchased all of the equity of Sterno Products for approximately \$160.0 million. On January 22, 2016, Sterno Products acquired Northern International, Inc. ("NII"), which sells flameless candles and outdoor lighting products through the retail segment.

## Results of Operations

The table below summarizes the income from operations data for Sterno Products for the three and nine months ended September 30, 2016 and September 30, 2015. The results of NII have been included from the date of acquisition through the end of the reporting period.

(in thousands)	Three months ended		Nine months ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
Net sales	\$55,582	\$ 31,710	\$156,692	\$ 98,680
Cost of sales	39,744	23,390	113,724	74,424
Gross Profit	15,838	8,320	42,968	24,256
Selling, general and administrative expenses	8,556	3,985	23,568	11,776
Management fees	125	125	375	375
Amortization of intangibles	1,621	1,503	4,930	3,819
Income from operations	\$5,536	\$ 2,707	\$14,095	\$ 8,286

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

## Net sales

Net sales for the three months ended September 30, 2016 were approximately \$55.6 million, an increase of \$23.9 million or 75.3% compared to the same period in 2015. The increase in net sales is a result of the acquisition of NII in January 2016 (\$23.5 million in net sales), and the timing of stocking programs of key Sterno customers.

## Cost of sales

Cost of sales for the three months ended September 30, 2016 were approximately \$39.7 million compared to approximately \$23.4 million in the same period of 2015. Cost of sales for NII were approximately \$16.9 million. Gross profit as a percentage of sales increased from 26.2% for the three months ended September 30, 2015 to 28.5% for the same period ended September 30, 2016. The increase in gross margin during the three months ended September 30, 2016 primarily reflects a favorable margin mix with the acquisition of NII, manufacturing efficiencies resulting from investment in automation and favorable trends in global commodity prices.

## Selling, general and administrative expense

Selling, general and administrative expense for the three months ended September 30, 2016 and 2015 was approximately \$8.6 million and \$4.0 million, respectively. Selling, general and administrative expense represented 15.4% of net sales for the three months ended September 30, 2016 as compared to 12.6% of net sales for the same period in 2015. The increase in selling, general and administrative expenses during the third quarter of 2016 reflects the acquisition of NII, which has historically had a higher selling, general and administrative expense as a percentage

of revenue, as well as an increase in staffing to strengthen sales and marketing and increased professional service costs associated with the acquisition of NII.

## Table of Contents

### Income from operations

Income from operations for the three months ended September 30, 2016 was approximately \$5.5 million, an increase of \$2.8 million when compared to the same period in 2015, as a result of those factors described above.

Nine months ended September 30, 2016 compared to nine months ended September 30, 2015

### Net sales

Net sales for the nine months ended September 30, 2016 were approximately \$156.7 million, an increase of \$58.0 million or 58.8% compared to the same period in 2015. The increase in net sales is a result of the acquisition of NII in January 2016 (\$57.8 million in net sales), offset by the timing of stocking programs of key Sterno customers.

### Cost of sales

Cost of sales for the nine months ended September 30, 2016 were approximately \$113.7 million compared to approximately \$74.4 million in the same period of 2015. Cost of sales for NII were approximately \$42.3 million, and includes \$1.2 million in expense associated with the inventory step-up recorded in connection with the preliminary purchase price allocation for NII. Gross profit as a percentage of sales increased from 24.6% for the nine months ended September 30, 2015 to 27.4% for the same period ended September 30, 2016. The increase in gross margin during the nine months ended September 30, 2016 primarily reflects a favorable margin mix with the acquisition of NII, manufacturing efficiencies resulting from investment in automation and favorable trends in global commodity prices.

### Selling, general and administrative expense

Selling, general and administrative expense for the nine months ended September 30, 2016 and 2015 was approximately \$23.6 million and \$11.8 million, respectively. Selling, general and administrative expense represented 15.0% of net sales for the nine months ended September 30, 2016 as compared to 11.9% of net sales for the same period in 2015. The increase in selling, general and administrative expenses during the nine months ended September 30, 2016 reflects the acquisition of NII, which has historically had a higher selling, general and administrative expense as a percentage of revenue, as well as an increase in staffing to strengthen sales and marketing and increased professional service costs associated with the acquisition of NII.

### Income from operations

Income from operations for the nine months ended September 30, 2016 was approximately \$14.1 million, an increase of \$5.8 million when compared to the same period in 2015, as a result of those factors described above.

## Liquidity and Capital Resources

### Liquidity

At September 30, 2016, we had approximately \$26.4 million of cash and cash equivalents on hand. 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:

(in thousands)	Nine months ended	
	September 30, 2016	September 30, 2015
Cash provided by operations	\$60,594	\$ 46,471
Cash (used in) provided by investing activities	(417,284 )	246,594
Cash provided by (used in) financing activities	300,407	(225,450 )
Effect of exchange rates on cash and cash equivalents	(3,197 )	(2,593 )

(Decrease) increase in cash and cash equivalents	\$(59,480)	\$ 65,022
--	------------	-----------

## Table of Contents

### Operating Activities:

For the nine months ended September 30, 2016, cash flows provided by operating activities totaled approximately \$60.6 million, which represents a \$14.1 million increase compared to cash provided by operations of \$46.5 million during the nine month period ended September 30, 2015 (from both continuing and discontinued operations). This increase is principally the result of changes in cash used for working capital in the nine months ended September 30, 2016 as compared to the same period in 2015, primarily as a result of the higher net income from continuing operations in 2016 compared to 2015, and the effect of the cash flows from add-on acquisitions.

### Investing Activities:

Cash flows used in investing activities for the nine months ended September 30, 2016 totaled approximately \$417.3 million, compared to \$246.6 million provided by investing activities in the same period of 2015. Capital expenditures in the nine months ended September 30, 2016 increased approximately \$4.2 million. The increase in capital expenditures is attributable to our acquisition of 5.11 Tactical in August 2016, and additional investment in manufacturing lines at Sterno, Advanced Circuits and Liberty during the first nine months of 2016 compared to the prior year. We expect capital expenditures for the full year of 2016 to be approximately \$18 million to \$20 million. The 2016 investing activities reflect the acquisition of NII by Sterno in January 2016 (\$35.6 million), EWS and Phoenix Soil by Clean Earth (\$33.1 million), Baby Tula by Ergobaby (\$65.0 million) and the Company's acquisition of 5.11 Tactical (\$395.4 million), offset by the proceeds from the partial divestiture of FOX shares (\$110.7 million) and the sale of Tridien (\$12.3 million). The Company also settled the escrow related to our sale of Camelbak during the third quarter of 2016, resulting in a payment of \$1.3 million.

### Financing Activities:

Cash flows provided by financing activities totaled approximately \$300.4 million during the nine months ended September 30, 2016 compared to cash flows used in financing activities of \$225.5 million during the nine months ended September 30, 2015. Highlights of financing activities include:

- The acquisition of 5.11 Tactical in August 2016, and the related increase in borrowings under our 2014 Credit Facility;
- The payments of our shareholder distributions of \$58.6 million in the nine months ended September 30, 2016 and 2015;
- Distributions of \$23.6 million paid during 2016 to noncontrolling shareholders as a result of the Liberty and ACI recapitalizations;
- Net borrowings during the nine months ended September 30, 2016 under our 2014 Credit Facility totaled \$412.1 million, including borrowings under our 2016 Incremental Term Loan, which was used to fund the acquisitions of 5.11 Tactical during the third quarter, EWS and Baby Tula during the second quarter, and the repurchase of Ergobaby common stock from noncontrolling shareholders during the third quarter.
- Distributions of \$16.8 million to the Holders of the allocation interest related to a Sale Event (March Offering of FOX) and a Holding Event (ACI).

### Inter-company 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 inter-company 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 principle on these inter-company 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 inter-company 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 inter-company debt using either cash on hand at the parent or our revolving 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.

During the second quarter of 2016, we completed a recapitalization at Advanced Circuits whereby the Company entered into an amendment to the inter-company loan agreement with Advanced Circuits (the "ACI Loan Agreement"). The ACI loan agreement was amended to provide for additional term loan borrowings of \$60.1 million and to extend the maturity date for the term loans. The ACI noncontrolling shareholders received approximately \$18.6 million in distributions as a result of the recapitalization.

Table of Contents

During the first quarter of 2016, we completed a recapitalization at Liberty whereby we entered into an amendment to the inter-company loan agreement with Liberty (the "Liberty Loan Agreement"). The Liberty Loan Agreement was amended to (i) provide for term loan borrowings of \$38.0 million and revolving credit facility borrowings of \$5.0 million to fund cash distributions totaling \$35.3 million to its shareholders, including the Company, and (ii) extend the maturity dates of the term loans and revolving credit facility. Liberty's noncontrolling shareholders received approximately \$5.3 million in distributions as a result of the recapitalization. Certain members of Liberty's management also exercised stock option immediately prior to the recapitalization, resulting in net proceeds from stock options at Liberty of \$3.8 million. The Company then purchased \$1.5 million in shares from members of Liberty management, resulting in Liberty's noncontrolling shareholders holding 11.4% of Liberty's outstanding shares subsequent to the recapitalization.

As of June 30, 2016, Manitoba Harvest was in default of certain financial covenants under the inter-company loan agreement with the Company. The Company waived the default by amending its inter-company loan agreement with Manitoba Harvest. The amendment includes certain provisions that provide relief of Manitoba Harvest's financial covenants through June 30, 2017.

As of September 30, 2016, we had the following outstanding loans due from each of our businesses:

(in thousands)

5.11 Tactical	\$178,059
Ergobaby	\$88,224
Liberty	\$53,075
Manitoba Harvest	\$46,911
Advanced Circuits	\$108,552
Arnold Magnetics	\$68,115
Clean Earth	\$173,645
Sterno Products	\$91,416

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 2014 Credit Facility; (iii) payments to CGM due pursuant to the Management Services Agreement 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.

#### FOX Equity Investment

In March 2016, we sold 2,500,000 of our FOX shares through a secondary offering. Concurrently with the offering, FOX purchased 500,000 of their shares directly from us, resulting in the sale of a total of 3,000,000 shares of FOX common stock (the "March Offering"). Total net proceeds from the March Offering was approximately \$47.7 million. Upon completion of the March Offering and purchase of shares by FOX, our ownership interest in FOX was reduced from approximately 41% to 33%. In August 2016, FOX closed on another secondary offering (the "August Offering") through which we sold 3,050,000 shares of FOX common stock for net proceeds of approximately \$63.0 million. The proceeds from the August Offering were used to pay down a portion of the outstanding amount of our 2014 Revolving Credit Facility. Upon completion of the August Offering, our ownership of FOX decreased from 33% to approximately 23%. We currently own approximately 8.6 million shares of FOX common stock. The sale of FOX shares in the March Offering and August Offering qualified as Sale Events under our LLC Agreement. Our Board of Directors declared a distribution of \$8.6 million and \$11.6 million, respectively, in

connection with the March Offering and August Offering. The profit allocation related to the March Offering was made in the quarter ended June 30, 2016, and the profit allocation payment related to the August Offering will be made during the fourth quarter of 2016.

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. The quarterly distribution for the three months ended September 30, 2016 was paid on October 27, 2016 and totaled \$19.5 million.

Table of Contents

## 2014 Credit Facility

On June 6, 2014 we entered in a new credit facility, the 2014 Credit Facility, which replaced our then existing 2011 Credit Facility entered into in October 2011. On August 31, 2016, we entered into an Incremental Facility Amendment to the 2014 Credit Agreement. The Incremental Facility Amendment provided an increase to the 2014 Revolving Credit Facility of \$150.0 million, and the 2016 Incremental Term Loan in the amount of \$250.0 million. The 2014 Credit Facility now provides for (i) revolving loans, swing line loans and letters of credit up to an maximum aggregate amount of \$550 million and matures in June 2019, (ii) a \$325 million term loan, and (iii) a \$250 million incremental term loan. Our 2014 Term Loan requires quarterly payments with a final payment of the outstanding principal balance due in June 2021. (Refer to Note I to the Condensed Consolidated Financial Statements for a complete description of our 2014 Credit Facility.)

In connection with the 2016 Incremental Facility Amendment, we incurred \$6.0 million in additional debt issuance costs which will be recognized as expense during the remaining term of the related 2014 Revolving Credit Facility and 2014 Term Loan and the 2016 Incremental Term Loan. The Incremental Facility Amendment did not change the due dates or applicable interest rates of the 2014 Credit Agreement. The quarterly payments for the term loan advances under the 2014 Credit Facility increased to approximately \$1.4 million per quarter. We used the proceeds from the Incremental Facility Amendment to fund the acquisition of 5.11 Tactical.

We had \$377.9 million in net availability under the 2014 Revolving Credit Facility at September 30, 2016. The outstanding borrowings under the 2014 Revolving Credit Facility includes \$5.1 million at September 30, 2016 of outstanding letters of credit.

The following table reflects required and actual financial ratios as of September 30, 2016 included as part of the affirmative covenants in our 2014 Credit Facility:

Description of Required Covenant Ratio	Covenant Ratio Requirement	Actual Ratio
Fixed Charge Coverage Ratio	greater than or equal to 1.50:1.0	4.76:1.0
Total Debt to EBITDA Ratio	less than or equal to 4.25:1.0	3.70:1.0

We intend to use the availability under our 2014 Credit Facility and cash on hand to pursue acquisitions of additional businesses to the extent permitted under our 2014 Credit Facility, to fund distributions and to provide for other working capital needs.

## Subsequent Events

## Profit Allocation Payment - Sale Event

The sale of FOX shares in August 2016 and the sale of Tridien in September 2016 qualified as Sale Events under our LLC Agreement. In November 2016 as a result of the FOX shares in August 2016 and the sale of Tridien, both qualifying as Sale Events, the Company's board of directors approved and declared a profit allocation payment of \$7.0 million which will be paid during the fourth quarter of 2016.

## Interest Expense

We recorded interest expense totaling \$23.2 million for the nine months ended September 30, 2016 compared to \$24.0 million for the comparable period in 2015. The components of interest expense and periodic interest charges on outstanding debt are as follows (in thousands):

	Nine months ended			
	September 30,			
	2016		2015	
Interest on credit facilities	\$12,612		\$14,137	
Unused fee on Revolving Credit Facility	1,356		1,062	
Amortization of original issue discount	536		503	
Unrealized losses on interest rate derivatives <sup>(1)</sup>	8,322		8,044	
Letter of credit fees	79		94	
Other	320		207	
Interest expense	\$23,225		\$24,047	
Average daily balance of debt outstanding	\$403,988		\$484,603	
Effective interest rate <sup>(1)</sup>	7.7	%	6.6	%

Table of Contents

<sup>(1)</sup> On September 16, 2014, we purchased an interest rate swap (the "New Swap") with a notional amount of \$220 million effective April 1, 2016 through June 6, 2021. The agreement requires us to pay interest on the notional amount at the rate of 2.97% in exchange for the three-month LIBOR rate. At September 30, 2016, the New Swap had a fair value loss of \$18.7 million, reflecting the present value of future payments and receipts under the agreement and is reflected as a component of interest expense and other non-current liabilities. Removing the effect of the unrealized loss on the interest rate swap results in an effective interest rate of 4.1% for the first nine months of 2016 and 4.4% for the first nine months of 2015. Refer to Note J - Derivatives and Hedging Activities of the condensed consolidated financial statements.

**Income Taxes**

We incurred income tax expense of \$9.8 million with an effective tax rate of 15.8% during the nine months ended September 30, 2016 compared to \$9.2 million with an effective income tax rate of 56.3% during the same period in 2015. Non-deductible costs at the corporate level, including the gain on our equity method investment in FOX in the nine months ended September 30, 2016, account for the majority of the remaining difference in our effective income tax rates in both periods. Certain foreign operations are subject to foreign income taxation under existing provisions of the laws of those jurisdictions. Pursuant to U.S. tax laws, earnings from those jurisdictions will be subject to the U.S. income tax rate when those earnings are repatriated. During the quarter ending September 30, 2016, management changed our previously asserted tax position that we planned to permanently re-invest foreign earnings of controlled foreign corporations at our Arnold subsidiary. The principal reason for changing our position is Arnold's planned repatriation of excess foreign cash to pay down the inter-company debt with the Company. We have recorded a deferred tax liability of \$2.8 million related to the Arnold's foreign subsidiaries as a result of the change in position pursuant to APB 23.

The components of income tax expense as a percentage of income from continuing operations before income taxes for the nine months ended September 30, 2016 and 2015 are as follows:

	Nine months ended September 30,	
	2016	2015
United States Federal Statutory Rate	35.0 %	35.0 %
State income taxes (net of Federal benefits)	0.2	7.6
Foreign income taxes	1.4	(6.0 )
Expenses of Compass Group Diversified Holdings, LLC representing a pass through to shareholders <sup>(1)</sup>	6.3	41.7
Effect of (gain) loss on equity method investment <sup>(2)</sup>	(33.3)	(20.4)
Impact of subsidiary employee stock options	0.7	1.0
Domestic production activities deduction	(0.6 )	(3.7 )
Effect of undistributed foreign earnings	4.5	—
Non-recognition of NOL carryforwards at subsidiaries	—	(0.1 )
Other	1.6	1.2
Effective income tax rate	15.8 %	56.3 %

<sup>(1)</sup> The effective income tax rate for the nine months ended September 30, 2016 and 2015 includes a significant loss at the Company's parent, which is taxed as a partnership.

<sup>(2)</sup> The equity method investment in FOX is held at the Company's parent, which is taxed as a partnership, resulting in the gain or loss on the investment being a reconciling item in deriving our effective tax rate.

Reconciliation of Non-GAAP Financial Measures

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

Table of Contents

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 income (loss) from continuing operations 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) non-controlling stockholder compensation, which generally consists of non-cash stock option expense; (ii) successful acquisition costs, which consist of transaction costs (legal, accounting, due diligences, 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 Management Services Agreement ("MSA"), as well as Integration Services Fees paid by newly acquired companies; (iv) impairment charges, which reflect write downs to goodwill or other intangible assets; (v) gains or losses recorded in connection with our equity method investment; (vi) gains or losses recorded in connection with the sale of fixed assets and (vii) foreign currency transaction gains or losses incurred in connection with the conversion of inter-company 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 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 table reconciles EBITDA and Adjusted EBITDA to income (loss) from continuing operations, which we consider to be the most comparable GAAP financial measure (in thousands):



Table of Contents

## Adjusted EBITDA

Nine months ended September 30, 2016

	Corporate	5.11 Tactical	Ergobaby	Liberty	Manitoba Harvest	Advanced Circuits	Arnold Magnetics	Clean Earth	Sterno Products	Consolidated
Net income (loss) <sup>(1)</sup>	\$49,623	\$(3,167)	\$3,192	\$3,942	\$(4,084)	\$7,297	\$(3,961 )	\$(3,544 )	\$4,783	\$54,081
Adjusted for:										
Provision (benefit) for income taxes	—	(1,963 )	2,242	2,614	(1,468 )	3,846	2,486	(832 )	2,853	9,778
Interest expense, net	22,840	6	—	—	7	—	(2 )	341	12	23,204
Intercompany interest	(36,432 )	1,206	3,405	3,172	2,932	5,619	5,046	9,156	5,896	—
Depreciation and amortization	667	5,237	6,306	2,099	5,256	2,938	7,035	16,380	8,617	54,535
EBITDA	36,698	1,319	15,145	11,827	2,643	19,700	10,604	21,501	22,161	141,598
Gain on sale of business	(2,134 )	—	—	—	—	—	—	—	—	(2,134 )
(Gain) loss on sale of fixed assets	—	—	—	48	2	(10 )	—	375	—	415
Non-controlling shareholder compensation	—	—	585	327	564	18	192	853	472	3,011
Acquisition expenses and other	98	2,063	799	—	—	—	—	738	189	3,887
Loss on disposal of assets	—	—	7,214	—	—	—	—	—	—	7,214
Integration services fee	—	292	—	—	500	—	—	—	—	792
Gain on equity method investment	(58,680 )	—	—	—	—	—	—	—	—	(58,680 )
Gain on foreign currency transaction and other	(2,396 )	—	—	—	—	—	—	—	—	(2,396 )
Management fees	18,800	83	375	375	261	375	375	375	375	21,394
Adjusted EBITDA	\$(7,614 )	\$3,757	\$24,118	\$12,577	\$3,970	\$20,083	\$11,171	\$23,842	\$23,197	\$115,101

<sup>(1)</sup> Net income (loss) does not include income (loss) from discontinued operations for the nine months ended September 30, 2016.

# Table of Contents

## Adjusted EBITDA

Nine months ended September 30, 2015

	Corporate	5.11 Tactical	Ergobaby	Liberty	Manitoba Harvest	Advanced Circuits	Arnold Magnetics	Clean Earth	Sterno Products	Consolidated
Net income (loss) <sup>(1)</sup>	\$ 140,556		\$ 8,576	\$ 2,968	\$ (3,103)	\$ 9,293	\$ 1,529	\$ (3,394 )	\$ 1,802	\$ 158,227
Adjusted for:										
Provision (benefit) for income taxes	(285 )		5,210	1,373	(1,293 )	4,898	(335 )	(1,485 )	1,123	9,206
Interest expense, net	23,737		—	—	6	—	6	298	—	24,047
Intercompany interest	(30,385 )		3,077	3,257	407	4,274	5,250	8,929	5,191	—
Depreciation and amortization	902		2,836	3,007	4,029	2,485	6,822	15,909	5,945	41,935
EBITDA	134,525		19,699	10,605	46	20,950	13,272	20,257	14,061	233,415
Gain on sale of businesses	(151,075 )		—	—	—	—	—	—	—	(151,075 )
(Gain) loss on sale of fixed assets	—	Not Applicable	—	7	1	—	(183 )	274	—	99
Non-controlling shareholder compensation	—		534	156	—	18	102	877	375	2,062
Acquisition related expenses	—		—	—	1,126	—	—	—	—	1,126
Integration services fee	—		—	—	250	—	—	1,875	1,125	3,250
Loss on equity method investment	(9,518 )		—	—	—	—	—	—	—	(9,518 )
Management fees	17,261		375	375	86	375	375	375	375	19,597
Adjusted EBITDA <sup>(2)</sup>	\$ (8,807 )		\$ 20,608	\$ 11,143	\$ 1,509	\$ 21,343	\$ 13,566	\$ 23,658	\$ 15,936	\$ 98,956

(1) Net income (loss) does not include income from discontinued operations for the nine months ended September 30, 2015.

(2) As a result of the sale of our Tridien subsidiary in September 2016, Adjusted EBITDA for the nine months ended September 30, 2015 does not include Adjusted EBITDA from Tridien of \$4.0 million.



Table of Contents

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 (used in) operating activities, which we consider to be the most directly comparable financial measure calculated and presented in accordance with GAAP.

# Table of Contents

	Nine Months Ended	
	September 30, 2016	September 30, 2015
(in thousands)		
Net income	\$54,554	\$167,306
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	53,972	49,743
Impairment expense	—	9,165
Loss on disposal of assets	7,214	—
Gain on sale of businesses	(2,134 )	(151,075 )
Amortization of debt issuance costs and original issue discount	2,363	2,154
Unrealized loss on interest rate and foreign currency hedges	8,322	8,044
Gain loss on equity method investment	(58,680 )	(9,518 )
Noncontrolling shareholder charges	3,012	2,627
Excess tax benefit on stock compensation	(366 )	—
Deferred taxes	(4,280 )	(3,863 )
Other	408	324
Changes in operating assets and liabilities	(3,791 )	(28,436 )
Net cash provided by operating activities	60,594	46,471
Plus:		
Unused fee on revolving credit facility <sup>(1)</sup>	1,355	1,062
Integration services fee <sup>(2)</sup>	792	3,250
Successful acquisition costs	3,888	1,126
Realized loss from foreign currency <sup>(4)</sup>	—	1,297
Excess tax benefit on stock compensation	366	—
Changes in operating assets and liabilities	3,791	28,436
Other	245	—
Less:		
Payments on swap	3,114	1,502
Maintenance capital expenditures: <sup>(3)</sup>		
Compass Group Diversified Holdings LLC	—	—
5.11 Tactical	540	—
Advanced Circuits	2,845	358
American Furniture	—	311
Arnold	1,625	2,038
CamelBak	—	1,295
Clean Earth	4,504	5,326
Ergobaby	441	1,333
Liberty	850	758
Manitoba Harvest	1,146	509
Sterno Products	1,408	1,047
Tridien	385	710
Realized gain from foreign currency <sup>(4)</sup>	2,396	—
Other	—	209
Estimated cash flow available for distribution and reinvestment	\$51,777	\$66,246
Distribution paid in April 2016/2015	\$(19,548)	\$(19,548 )
Distribution paid in July 2016/2015	(19,548 )	(19,548 )
Distribution paid in October 2016/ 2015	(19,548 )	(19,548 )
	\$(58,644)	\$(58,644 )

- (1) Represents the commitment fee on the unused portion of the revolving credit facilities.
- (2) Represents fees paid by newly acquired companies to the Manager for integration services performed during the first year of ownership, payable quarterly.

## Table of Contents

- (3) Represents maintenance capital expenditures that were funded from operating cash flow, net of proceeds from the sale of property, plant and equipment, and excludes growth capital expenditures of approximately \$1.6 million for the nine months ended September 30, 2016 and \$1.0 million for the nine months ended September 30, 2015.
- (4) Reflects the foreign currency transaction gain or loss resulting from the Canadian dollar intercompany loans issued to Manitoba Harvest.

### Seasonality

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

### Related Party Transactions

#### ACI Recapitalization

During the second quarter of 2016, the Company completed a recapitalization at ACI whereby the Company entered into an amendment to the intercompany debt agreement with ACI (the "ACI Loan Agreement"). The ACI Loan Agreement was amended to provide for additional term loan borrowings of \$61.0 million to fund a cash distributions to shareholders totaling \$60.1 million. Minority interest shareholders of Advanced Circuits, including certain members of management at Advanced Circuits, received total distribution proceeds of \$18.4 million. The Company used cash on hand to fund the distribution to minority shareholders.

#### Liberty Recapitalization

During the first quarter of 2016, we completed a recapitalization at Liberty whereby we entered into an amendment to the intercompany loan agreement with Liberty (the "Liberty Loan Agreement"). The Liberty Loan Agreement was amended to (i) provide for term loan borrowings of \$38.0 million and revolving credit facility borrowings of \$5.0 million to fund cash distributions totaling \$35.3 million to its shareholders, including the Company, and (ii) extend the maturity dates of the term loans and revolving credit facility. Liberty's noncontrolling shareholders received approximately \$5.3 million in distributions as a result of the recapitalization. Certain members of Liberty's management also exercised stock option immediately prior to the recapitalization, resulting in net proceeds from stock options at Liberty of \$3.8 million. The Company then purchased \$1.5 million in shares from members of Liberty management, resulting in Liberty's noncontrolling shareholders holding 11.4% of Liberty's outstanding shares subsequent to the recapitalization.

#### Ergobaby Share Repurchase

In June 2016, Ergobaby repurchased 77,425 shares of Ergobaby common stock from certain noncontrolling interest shareholders for a total purchase price of \$15.4 million. Ergobaby financed the repurchase of shares with an increase to the intercompany debt facility with the Company. Subsequent to the repurchase, the noncontrolling interest in Ergobaby is 83.9% on a primary basis and 76.2% on a fully diluted basis. The shares have been accounted for as treasury shares by Ergobaby.

#### Equity method investment in FOX

During the first quarter of 2016, the Company's equity method investment, FOX, closed on a secondary public offering of 2,500,000 shares of FOX common shares held by the Company. Concurrently with the closing of the March Offering, FOX repurchased 500,000 shares of FOX common stock held by the Company. As a result of the sale of shares through the March Offering and the repurchase of shares by FOX, the Company sold a total of 3,000,000 shares of FOX common stock, with total net proceeds of approximately \$47.7 million. Upon completion of the March Offering and repurchase of shares by FOX, the Company's ownership interest in FOX was reduced from approximately 41% to 33%. The sale of a portion of the Company's FOX shares in March 2016 qualified as a Sale Event under the Company's LLC Agreement. During the second quarter, the Company's board of directors declared a distribution to the Holders of the Allocation Interests of \$8.6 million in connection with the Sale Event of FOX. The



profit allocation payment was made during the quarter ended June 30, 2016.

During the third quarter of 2016, FOX closed on a secondary public offering of 4,025,000 shares held by certain FOX shareholders, including the Company. The Company sold a total of 3,500,000 shares of FOX common stock in the August Offering, for total net proceeds of \$63.0 million. Upon completion of the August offering, our ownership of FOX decreased from approximately 33% to approximately 23%. The sale of the portion of our FOX shares in August 2016 qualified as a Sale Event under the

Table of Contents

Company's LLC Agreement. Our board of directors declared a distribution to the Holders of the Allocation Interests in connection with the August Sale Event of FOX. The profit allocation payment will be made during the quarter ended December 31, 2016.

The following table reflects the year to date activity from our investment in FOX (in thousands):

	2016
Balance January 1, 2016	\$249,747
Proceeds from sale of FOX shares	(52,110 )
Discount on sale of FOX shares	4,425
Mark-to-market adjustment - March 31, 2016	(10,623 )
Balance March 31, 2016	\$191,439
Mark-to-market adjustment - June 30, 2016	18,889
Balance at June 30, 2016	\$210,328
Proceeds from sale of FOX shares	(69,335 )
Discount on sale of FOX shares	6,335
Mark-to market adjustment - September 30, 2016	50,414
Balance at September 30, 2016	\$197,742

## Contractual Obligations and Off-Balance Sheet Arrangements

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

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

The table below summarizes the payment schedule of our contractual obligations at September 30, 2016:

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations <sup>(1)</sup>	\$870,963	\$15,883	\$77,879	\$239,719	\$537,482
Operating lease obligations <sup>(2)</sup>	74,485	10,914	21,785	13,581	28,205
Purchase obligations <sup>(3)</sup>	252,403	167,441	42,562	42,400	—
Total <sup>(4)</sup>	\$1,197,851	\$194,238	\$142,226	\$295,700	\$565,687

<sup>(1)</sup> Reflects commitment fees and letter of credit fees under our 2014 Revolving Credit Facility and amounts due, together with interest on our 2014 Term Loan Facility.

<sup>(2)</sup> Reflects various operating leases for office space, manufacturing facilities and equipment from third parties with various lease terms running from one to fourteen years.

Reflects non-cancelable commitments as of September 30, 2016, including: (i) shareholder distributions of \$78.2 million; (ii) estimated management fees of \$21.6 million per year over the next five years, and (iii) other

<sup>(3)</sup> 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 \$0.4 million in liabilities associated with

<sup>(4)</sup> unrecognized tax benefits as of September 30, 2016 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.



## Table of Contents

### 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, 2015, as filed with the SEC.

### 2016 Annual Impairment Testing - Goodwill and Indefinite Lived Impairment Testing

#### Goodwill

Goodwill represents the excess amount of the purchase price over the fair value of the assets acquired. Our goodwill and indefinite lived intangible assets are tested for impairment on an annual basis as of March 31<sup>st</sup>, and if current events or circumstances require, on an interim basis. Goodwill is allocated to various reporting units, which are generally an operating segment or one level below the operating segment. Each of our businesses represents a reporting unit except Arnold, which is comprised of three reporting units, and each reporting unit is included in our annual impairment test.

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. At March 31, 2016, we determined that the Tridien reporting unit, which we sold in September 2016 and is presented as a discontinued operation, required further quantitative testing (step 1) because we could not conclude that the fair value of the reporting unit exceeds its carrying value based on qualitative factors alone. For the step 1 quantitative impairment test at Tridien, the Company utilized both the market approach and the income approach, with a 50% weighting assigned to each method. The weighted average cost of capital used in the income approach at Tridien was 14.1%. Results of the step 1 quantitative testing of Tridien indicated that the fair value of Tridien exceeded its carrying value. For the reporting units that were tested qualitatively, the results of the qualitative analysis indicated that the fair value of those reporting units exceeded their carrying value.

#### Arnold

Arnold has experienced declines in revenue and operating income during the first nine months of 2016 as compared to the prior year. The results at Arnold may continue to be lower than forecast and as a result, it may be necessary to perform interim Step 1 goodwill impairment testing at Arnold in the fourth quarter of 2016.

#### 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 \$73.0 million. The results of the qualitative analysis of our indefinite lived intangible assets, which we completed as of March 31, 2016, indicated that the fair value of the indefinite lived intangible assets exceeded their carrying value.

#### Long lived assets

#### Orbitbaby

During the second quarter of 2016, Ergobaby's board of directors approved a plan to dispose of the Orbitbaby product line. Ergobaby determined at the time the plan was approved that the carrying value of the long lived assets associated with the Orbitbaby product line was not recoverable, and therefore, Ergobaby recorded a loss on disposal of assets of \$7.2 million related to the write off of the long-lived assets of Orbitbaby. The loss is comprised of the write-off of intangible assets of \$5.5 million, property, plant and equipment of \$0.4 million, and other assets of \$0.8 million. Ergobaby will continue to sell the remaining Orbitbaby inventory through the end of 2016. Ergobaby recorded additional expense of \$0.6 million in the third quarter of 2016, primarily related to the early termination of the Orbitbaby lease. In October 2016, Ergobaby sold a majority of the Orbit Baby intellectual property

Table of Contents

and tooling assets. The proceeds of the sale will reduce the loss recorded on disposal of assets by approximately \$1.0 million in the fourth quarter of 2016.

Recent Accounting Pronouncements

Refer to Footnote B to our condensed consolidated financial statements.

**ITEM 3. – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes to our market risk since December 31, 2015. For a further discussion of our exposure to market risk, refer to Part II, Item 7A, "Quantitative and Qualitative Disclosures about Market Risk," contained in our Annual Report on Form 10-K for the year ended December 31, 2015.

**ITEM 4. – CONTROLS AND PROCEDURES**

As required by 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 Rule 13a-15(e), as of September 30, 2016. Based on that evaluation, the Holdings' Regular Trustees and the Chief Executive Officer and Chief Financial Officer of the Company concluded that Holdings' and the Company's disclosure controls and procedures were effective as of September 30, 2016.

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

Table of Contents

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Legal proceedings associated with the Company's and Holdings' business together with legal proceedings for the businesses have not changed materially from those disclosed in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2015 as filed with the SEC on February 29, 2016.

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" disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC on February 29, 2016.

ITEM 6. Exhibits

Exhibit Number Description

10.1	Commitment Letter dated August 1, 2016, from Bank of America, N.A., and Merrill Lynch, Pierce and Smith Incorporated (incorporated by reference to Exhibit 10.1 of the Form 8-K filed on August 1, 2016 (File No. 001-34927))
10.2	Third Amendment to the Credit Agreement, dated August 15, 2016, by and among Compass Group Diversified Holdings LLC, Bank of America, N.A., and the lenders thereto (incorporated by reference to Exhibit 10.1 of the Form 8-K filed on August 15, 2016 (File No. 001-34927))
10.3	First Incremental Facility Amendment, dated August 31, 2016 by and among Compass Group Diversified Holdings LLC, Bank of America, N.A., Exhibit 10.1 of the Form 8-K filed on August 31, 2016 (File No. 001-34927))
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant
32.1**	Certification of Chief Executive Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document

101.LAB\* XBRL Taxonomy Extension Label Linkbase Document

70

---



Table of Contents

101.PRE\* XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

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

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, 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: November 2, 2016

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, 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: November 2, 2016

Table of Contents

EXHIBIT INDEX

Exhibit Number Description

10.1	Commitment Letter dated August 1, 2016, from Bank of America, N.A., and Merrill Lynch, Pierce and Smith Incorporated (incorporated by reference to Exhibit 10.1 of the Form 8-K filed on August 1, 2016 (File No. 001-34927))
10.2	Third Amendment to the Credit Agreement, dated August 15, 2016, by and among Compass Group Diversified Holdings LLC, Bank of America, N.A., and the lenders thereto (incorporated by reference to Exhibit 10.1 of the Form 8-K filed on August 15, 2016 (File No. 001-34927))
10.3	First Incremental Facility Amendment, dated August 31, 2016 by and among Compass Group Diversified Holdings LLC, Bank of America, N.A., Exhibit 10.1 of the Form 8-K filed on August 31, 2016 (File No. 001-34927))
31.1*	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer of Registrant
31.2*	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer of Registrant
32.1**	Certification of Chief Executive Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith.

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