



Compass Diversified Hlds (CODI)

Updated December 12th, 2022 by Jonathan Weber

Key Metrics

Current Price:	\$18	5 Year CAGR Estimate:	11.8%	Market Cap:	\$1.3B
Fair Value Price:	\$24	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	01/12/23 ¹
% Fair Value:	75%	5 Year Valuation Multiple Estimate:	5.9%	Dividend Payment Date:	01/25/23 ²
Dividend Yield:	5.6%	5 Year Price Target	\$26	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	B	Rating:	Buy

Overview & Current Events

Compass Diversified Holdings is a private equity firm that specializes in acquisition in the middle market – loosely defined as businesses with owner earnings between \$10 million and \$500 million. Compass Diversified went public in 2006 and since that time, it has grown into a company that generates about \$2.2 billion in annual revenue. The company purchases controlling stakes in small companies and holds them indefinitely. Compass Diversified Holdings has about ten different subsidiaries at most times, but there are regular changes in the portfolio.

Compass Diversified Holdings reported its most recent quarterly earnings results in November. The company announced that its revenues totaled \$600 million during the quarter, which was 22% more than the revenues that Compass Diversified generated during the previous year's quarter. The company beat the top line estimate easily, by \$50 million. Compass Diversified was able to generate adjusted EBITDA of \$98 million during the quarter, up 27% year over year.

Compass Diversified Holdings' non-GAAP earnings-per-share were \$0.67, but profits are oftentimes not reflective of the company's ability to generate cash flows. Compass Diversified usually generates cash flows that are higher than its reported net profits, which sometimes are even negative. For 2022, Compass Diversified has increased its EBITDA guidance range to \$460 million - \$470 million, which is well above the \$330 million of EBITDA generated in 2021. Compass Diversified cut its dividend by 31% this year, bringing the payout to \$0.25 per quarter, or \$1 per year.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
CF/S	\$0.97	\$2.37	\$1.29	\$1.01	\$2.36	\$2.26	\$1.91	\$1.73	\$1.71	\$1.99	\$2.40	\$2.65
DPS	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.44	\$1.00	\$1.00
Shares³	48	48	54	54	60	60	60	60	65	67	68	75

Compass Diversified's cash flow history – which is the sum of reported earnings plus depreciation – is checkered to say the least, as the company's businesses performed unfavorably in some conditions. Its exposure to different niche industries is part of its appeal, but also results in somewhat spotty cash flow growth rates.

Compass Diversified will, we believe, achieve some growth in the long run, through revenue growth, but also through improved net margins and a lower tax rate. Gross margins had risen substantially before the pandemic, a trend we expect will persist once the crisis has ended. The company relies heavily upon preferred stock and debt, and while these forms of accessing capital can be expensive, they are preferable to issuing too many common shares as that dilutes shareholders and makes the high-yielding dividend even costlier. As a response to the pandemic, Compass nevertheless decided to issue 5 million new shares to shore up its balance sheet.

¹ Estimated date

² Estimated date

³ In Millions

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/CF	15.2	8.3	12.6	15.7	7.6	7.5	6.5	14.5	11.1	15.5	7.5	10.0
Avg. Yld.	10.1%	8.3%	8.1%	8.7%	8.7%	8.4%	11.5%	5.8%	7.6%	4.6%	5.6%	3.8%

Compass Diversified trades at around 7-8 times this year's forecasted cash flow, following a share price decline since our last update. The company did see some significant ups and downs in its cash flow generation over the years, depending on the timing of acquisitions and asset sales. We believe that a 10 times cash flow multiple would represent a fair valuation for the company's shares, shares thus look undervalued today.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	148%	60.8%	112%	143%	61.0%	63.7%	75.3%	83.2%	84.2%	72.4%	41.7%	37.7%

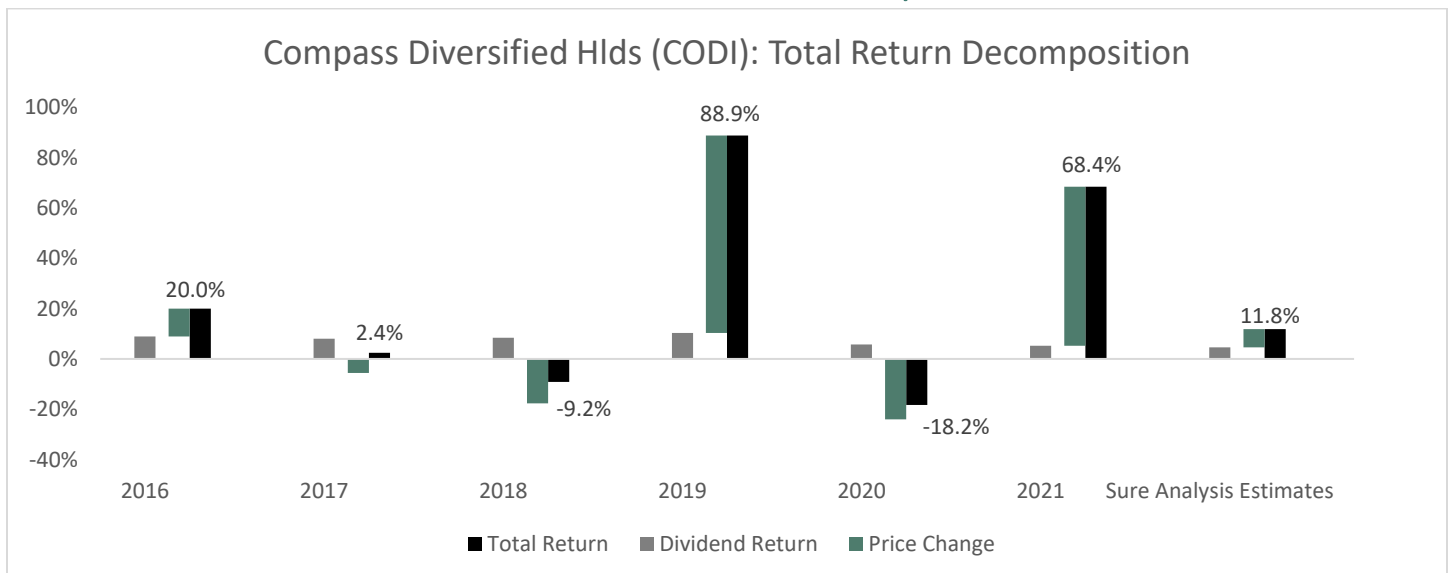
Compass Diversified's dividend payout ratio, measured by dividend payments relative to cash flows, has been above 100% several times during the last decade, although Compass Diversified chose to keep the dividend intact during most of those years. In early 2022, however, Compass Diversified chose to cut its dividend by around one-third. This has brought the dividend payout ratio to a rather undemanding level in the 40s.

Compass Diversified's results during the last financial crisis and the following years were not very stable, as there were considerable ups and downs in Compass Diversified's earnings and cash flows. Therefore, the company is not resilient during recessions and does not look like a very suitable stock for risk-averse investors. Compass Diversified is a leveraged buyout shop that competes with a wide range of peers, so it does not hold any meaningful competitive advantages.

Final Thoughts & Recommendation

Compass Diversified's share price has moved down a lot in 2022 so far, partially due to its decision to cut its dividend. Shares trade below fair value today, we believe. Compass Diversified is not a low-risk stock, and the recent dividend cut has hurt Compass Diversified's income generation potential. We rate shares a buy nevertheless, as the forecasted total returns are compelling and since Compass Diversified has increased its guidance this fall despite macro headwinds.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	885	741	637	728	978	1,003	1,357	1,263	1,360	1,842
Gross Profit	279	236	205	241	327	361	470	457	495	726
Gross Margin	31.5%	31.9%	32.2%	33.1%	33.4%	36.0%	34.6%	36.2%	36.4%	39.4%
SG&A Exp.	179	144	150	162	247	293	364	344	378	506
D&A Exp.	49	33	40	53	86	82	91	83	93	118
Operating Profit	70	72	32	50	44	33	57	59	55	140
Operating Margin	7.9%	9.7%	5.0%	6.9%	4.5%	3.3%	4.2%	4.7%	4.1%	7.6%
Net Profit	(4)	68	279	162	55	28	(6)	302	23	115
Net Margin	-0.4%	9.2%	43.8%	22.2%	5.6%	2.8%	-0.4%	23.9%	1.7%	6.2%
Free Cash Flow	34	56	61	69	87	43	73	58	120	94
Income Tax	21	19	5	15	9	(24)	10	10	10	18

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	955	1,045	1,547	1,421	1,777	1,820	2,372	1,892	2,599	3,144
Cash & Equivalents	18	113	22	85	40	40	49	100	60	157
Accounts Receivable	101	112	119	106	181	215	206	191	207	268
Inventories	127	153	58	60	213	247	307	317	351	562
Goodwill & Int. Ass.	598	557	678	741	1,031	1,112	1,087	1,000	1,501	1,688
Total Liabilities	499	476	739	548	883	894	1,453	726	1,378	1,860
Accounts Payable	52	63	49	46	62	85	77	70	92	120
Long-Term Debt	270	283	489	312	557	590	1,104	394	899	1,285
Shareholder's Equity	415	473	767	826	856	777	666	811	796	808
LTD/E Ratio	0.65	0.60	0.64	0.38	0.65	0.68	1.28	0.35	0.82	1.16

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	-0.4%	6.8%	21.5%	10.9%	3.4%	1.6%	-0.3%	14.2%	1.0%	4.0%
Return on Equity	-0.9%	15.3%	44.9%	20.3%	6.5%	3.4%	-0.8%	40.9%	2.8%	14.3%
ROIC	-0.5%	8.6%	25.9%	13.0%	4.1%	1.9%	-0.3%	16.8%	1.2%	4.9%
Shares Out.	48	48	54	54	60	60	60	60	65	67
Revenue/Share	18.32	15.34	12.97	13.41	17.92	16.74	22.66	21.09	21.53	28.18
FCF/Share	0.70	1.16	1.24	1.27	1.60	0.72	1.23	0.96	1.90	1.44

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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