CEOCFO Interviews & News!

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Compass Diversified Holdings Is Finding Little Competition And A Lot Of Success In Acquiring Growing Middle Market Companies

COMPASS DIVERSIFIED HOLDINGS

Financial
Diversified Investments
(CODI-NASDAQ)

Compass Diversified Holdings

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I. Joseph J. M. Massoud
Chief Executive Officer

BIO:
I. Joseph Massoud has served as a director of the Company since December 2005, as well its chief executive officer since its inception on November 18, 2005. Mr. Massoud has also been the president of the Company's manager and its predecessor since 1998. Previously, Mr. Massoud was with Petroleum Heat and Power, Inc., Colony Capital, Inc. and McKinsey & Co. Mr. Massoud currently serves as a director for all of the Company's subsidiary companies, as well as for Teekay GP LLC, the general partner of Teekay LNG Partners LP, a NYSE company. Mr. Massoud is a graduate of Claremont McKenna College and the Harvard Business School.

Company Profile:
CODI was formed to acquire and manage a group of middle market businesses that are headquartered in North America. CODI provides public investors with an opportunity to participate in the ownership and growth of companies which have historically been owned by private equity firms, wealthy individuals or families. CODI's disciplined approach to its target market provides opportunities to methodically purchase attractive businesses at values that are accretive to its shareholders. For sellers of businesses, CODI's unique structure allows CODI to acquire businesses efficiently with no financing contingencies and, following acquisition, to provide its companies with substantial access to growth capital.

Interview conducted by:
Lynn Fosse, Senior Editor
CEOCFOinterviews.com

CEOCFO: Mr. Massoud, what was your vision when you started as CEO and where are you today?
Mr. Massoud: "When we formed Compass Diversified Holdings in 2006 at the time of our public offering, we acquired four businesses at the time that we had managed as part of a portfolio for a charitable foundation. Our vision was that public investors, both institutional and retail, should have the opportunity to invest in growing middle market companies with the transparency and liquidity and governance provided by the public markets. Heretofore, the only way to really access this asset class has been as an investor in a private partnership, lacking liquidity, transparency and governance. Where we are today is we now have eight companies and in total they have about 120 million dollars of cash flow. We pay a distribution to our shareholders, which we have grown by over 24% since our IPO less than two years ago and the current annual distribution to our shareholders is $1.30 per share. Last year we earned over $1.60 per share, so there is substantial coverage of that distribution and we believe we have created a very interesting vehicle for public investors to access a dynamic asset class that typically has not been available."

CEOCFO: What is the common thread in the companies that you have under your belt?
Mr. Massoud: "There are some broad common threads; the first is that our companies need to be in industries that we understand. They need to be in industries that aren't subject to obsolescence or technological change, these tend to be basic manufacturing, service or distribution industries. In each of these businesses, we back current management to acquire them from a former owner, either a historic family founder or a large corporation, so they are not hostile acquisitions, we always back management. The third thing is they tend to base our acquisitions on valuations that are not dependent on best-case performance, but that are very good valuations for shareholders.

We are very methodical and patient, we have acquired on average two companies a year in the ten years that we have been doing this. We need to have identified, upfront with management, specific operational and marketing levers that we think we can work on with them to grow the business going forward."

CEOCFO: What is your relationship with the companies you acquire?
Mr. Massoud: "From a governance point of view, we tend to own 60 to 90% of these companies. We only make acquisitions when we are the control shareholder. In terms of communication with the companies, it varies--at least weekly, but very frequently, if we are working on a specific operational initiative or an add-on acquisition for a subsidiary, it could be daily or even multiple times per day. We assemble outside boards for each of our subsidiary companies and those boards include members from the Compass team, members from management, as well as industry third-party board members who we think can have a lot of value to specific subsidiaries niches."

CEOCFO: Have you ever exited a company and what is your criteria?
Mr. Massoud: "We have exited one business since forming the public company, which is a business called Crosman, which is the leading air gun manufacturer in the world, which is what most people think of as a BB gun. We have certainly exited a great number of companies in the ten years that we have done this in our predecessor entity, managing money on behalf of the Kattegat Trust. The criteria varies, it is case-by-case, but it tends to be that we believe that we are in a certain point in the history of the company where we can receive enough in proceeds for the sale of our interest that we can reinvest to create more cash flow for our shareholders. It is a matter of whether we think we have achieved the growth that we believe is most readily achievable – have we squeezed most of that orange? You never want to squeeze all of the orange, but have we squeezed much of the orange, does the market gives us a multiple that gives us credit for the growth, and very importantly, can we redeploy that capital in the current environment and create more opportunities for our shareholders?"

CEOCFO: Your acquisitions tend to be niche businesses; will you give us a few examples?
Mr. Massoud: "I will give you the first one which seems a little counter intuitive to some people, but we own a circuit board manufacturer and the first comment that we frequently get is circuit board manufacturing is that it is a tough business, it has moved to Asia, and broadly defined, that is true. Our business is the number-one player in North America by a factor of more than two times in the prototype and quick-turn manufacture of circuit boards. We have 8,000 customers primarily in the R&D industries, no one represents more than 1%, and when they need five or eight circuit boards in 48 hours and they need them to be 100% accurate and delivered on-time, they come to us, they don't look to order the circuit boards from Taiwan. If they need 10,000 in a month and they want to pay $10.00 a board that is a very different story. There is an example of a niche industry that has been growing. When we acquired the business in 2004, they had about $14 million in cash flow, and today have over $22 million in cash flow. It is a very solid business that is dominant in its space, which is the quick-turn manufacturer of R&D in prototypes circuit board. Another example would be a company like Sylvue, which we bought from Dow and Pilkington. Sylvue is the number-one manufacturer of hard coatings for polycarbonates, used primarily used in optical applications. For example, if you are wearing a pair of glasses today and you bought anti-glare or anti-abrasion coatings because you didn't want your lens to scratch easily, you didn't want to have glare, it is very highly likely that you are wearing our coatings,

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- I. Joseph J. M. Massoud

Another example would be if you are wearing sun glasses made by Oakley or Nike or Maui Jim, there is a high likelihood that the manufacturer of those lenses used our coatings not only for anti-abrasion and anti-glare, but also in UV coatings. There is a tight little niche where we are the number-one player and it is a patented product and it is a growing business. There are a lot of future applications in coating, such as for electronics, if you think about your PDAs, carrying your cell phones that are designed to play more video, you need better polycarbonate coatings that ensure screen quality.

A third example, is a business we own called Aeroglide, which is the number-one manufacturer in the world of industrial driers, so if you think of the machine that you put an English muffin in to toast it, that is a very simple drying and toasting application. If you now think of a cereal manufacturer that needs to create millions of flakes that are originally wet, that need to be dried and toasted, where the stock in trade is that any time you open that cereal box since you were a child, the corn flakes crunched exactly the same as they did the day before and the same as they will tomorrow, you realize what a complex application it is to produce, as energy efficiently as possible, a machine that dries and toasts uniformly time after time in a series of geographic regions and meeting a series of specifications. So Aeroglide is the number-one player in this industry. Those are some examples of small niches that you and I might not think of everyday that are important industries in reasonably small industries in the scope of the world, where we own companies that are dominant players."

CEOCFO: It sounds as if the current economic climate doesn't have much effect on the companies you own!
Mr. Massoud: "It varies--we have a company in the staffing industry, which is economically cyclical. We have one of

the very few highly profitable furniture manufacturing companies in the US. It is focused on the low end of the market, and is seeing an impact, not as much as the remainder of furniture industry. I would say that one thing we hope to see in 2008 is that our business as a whole will grow in the mid single digits, as certain of our companies will have a lot of strength and will grow, while others won't grow or maybe even will decline with the economy, but on the whole, the diversified portfolio will show growth."

CEOCFO: What do you and Compass know, that allows you to bring value to the companies that you look at or own, that perhaps others don't see?

Mr. Massoud: "There are not a lot of people focusing on this niche. Even in the private equity world, people tend to want to grow larger and larger and move beyond this space. This is reasonably fertile ground to acquire businesses because there is not a whole lot of competition. In fact, investors tend to either like very small pre-cash flow venture type companies because they think there are opportunities for 100x type returns, or they like much bigger companies. We think where we operate, working with companies that have cash flow between $10 million and $40 million, I don't want to say it is not competitive, but it is less competitive. We are just very patient, and because of our structure, we don't have a fund where we committed to limited partners that we would invest a billion dollars in three or four years, so every marginal transaction is one where we say we need to deploy the capital. Our patience allows us to pick our spots. We end up investing with companies that have a real reason to exist, not dependent on one core manager, but that have deep and strong management teams. We bring some basic skills; I am a former McKinsey person, we have ex Bain people, we have some former operators. We bring basic consulting talents and skills to work with the management teams of our companies to apply some fundamental quantitative analysis to questions on marketing or operations. Larger companies either do the same analyses themselves, because they have strategic development departments or they go out and hire Bain or McKinsey. At this size company, you rarely see these companies reaching out to access those kinds of resources. We are trying to bring certain quantitative analyses and techniques to companies that are very well managed, but maybe haven't quite thought through the issues the same way."

CEOCFO: What is the financial picture of the company?

Mr. Massoud: "We have about $120 million in cash flow. We only have $200 million in debt so we have less than two times debt to EBITDA. We have a debt facility, including an acquisition revolver, giving us access to about five hundred million dollars, so we have a lot of liquidity right now. We just refinanced in November of 2007, and we don't have any significant maturities until November 2012. In a lot of ways, we are in a very good position right now because we don't have any liquidity concerns. 2008 has been busy for us already, we have made a couple acquisitions and we expect over the next year and a half, as you read more about the credit crisis, it will be a good thing for us because we are positioned with a fair amount of liquidity now, but it doesn't mean that you can go and buy the first company that you see. There is a dynamic for a lot of people who own businesses who have been thinking about selling and have pulled them off the market and are just waiting for a better environment; in our world, you can't force acquisitions. To the extent that there are sellers interested in selling, we are one of the few options that are out there where someone has guaranteed liquidity and not the financing contingency that can create a lot of risk."

CEOCFO: Is Wall Street paying attention?

Mr. Massoud: "Wall Street was paying attention, we came out at $15.00, and in May 2006 the stock went up over $18.00. We did a follow on offering which dragged the stock price down a little bit to sixteen, it rebounded in the eighteen range and then when the "financial crisis" occurred, our stock came down. We haven't suffered as much as most of the financials or as much as someone like a Blackstone which is an asset manager or as much as the banks. We have held in there very well compared to the financials, but the general financial sector malaise certainly had an impact on our stock prices, so we find ourselves now at $12.50 or what ever it was this morning, paying almost an 11% yield with substantial coverage of that cash flow. We don't pay out 90 or a 100% of our cash flow, we pay out only 60 or 70%. There is really not a lot of risk to that yield. I would say that our investors understand the story and like the story, but I think we were impacted by the general finance cycle. My hope is that in 2008 we will perform as I expect; we will continue to tell the world we are performing well. I think people will be pleasantly surprised. I do not think there is much of a chance at all that we will reduce our distribution, I think there is a real chance we will increase it, and if we do that, I think people will once again realize what it is they liked about the story originally. I think people like the story, but there is a general toughness in the financial space right now. Even though we don't look at all like Citibank or other financials, there is a general negativity right now around the whole financial space."

CEOCFO: Final thoughts; what should people reading this interview remember most?

Mr. Massoud: "We have eight businesses that are market leaders that are each performing well, and together are worth something like $17.00 to $22.00 per share, which is much higher than the current valuation. It is a great opportunity, because we have been grouped with the financial sector, to buy a set of strong growing businesses at a deep discount than what they are worth."

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