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Compass Diversified Holdings  
Form 10-K  
February 27, 2019

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

Form 10-K  
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2018

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-34927

Compass Diversified Holdings  
(Exact name of registrant as specified in its charter)

Delaware 57-6218917  
(Jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)  
Commission File Number: 001-34926

Compass Group Diversified Holdings LLC  
(Exact name of registrant as specified in its charter)

Delaware 20-3812051  
(Jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

301 Riverside Avenue  
Second Floor 06880  
Westport, CT  
(Address of principal executive offices) (Zip Code)  
(203) 221-1703  
(Registrants' telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Shares representing beneficial interests in Compass Diversified Holdings ("common shares")	New York Stock Exchange
Series A Preferred Shares representing Series A Trust Preferred Interest in Compass Diversified Holdings ("Series A Preferred Shares")	New York Stock Exchange
Series B Preferred Shares representing Series B Trust Preferred Interest in Compass Diversified Holdings ("Series B Preferred Shares")	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrants are collectively a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrants are collectively not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

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Yes  No

Indicate by check mark whether the registrants (1) have 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 registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrants have submitted electronically and posted on their corporate website, 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 registrants were required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrants are collectively a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrants have elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the outstanding common shares of trust stock held by non-affiliates of Compass Diversified Holdings at June 30, 2018 was \$878,535,519 based on the closing price on the New York Stock Exchange on that date. For purposes of the foregoing calculation only, all directors and officers of the registrant have been deemed affiliates. There were 59,900,000 common shares of trust stock without par value outstanding at February 22, 2019.

Documents Incorporated by Reference

Certain information in the registrant's definitive proxy statement to be filed with the Commission relating to the registrant's 2019 Annual Meeting of Shareholders is incorporated by reference into Part III.

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NOTE TO READER

In reading this Annual Report on Form 10-K, references to:

the “Trust” and “Holdings” refer to Compass Diversified Holdings;

the “Company” refer to Compass Group Diversified Holdings LLC;

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

the “Manager” refer to Compass Group Management LLC (“CGM”);

the “Trust Agreement” refer to the Second Amended and Restated Trust Agreement of the Trust dated as of December 6, 2016;

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

the “2018 Credit Facility” refer to the amended and restated credit agreement entered into on April 18, 2018 among the Company, the Lenders from time to time party thereto (the “Lenders”), Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer (the “agent”) and other agents party thereto.

the “2018 Revolving Credit Facility” refers to the \$600 million in revolving loans, swing line loans and letters of credit provided by the 2018 Credit Facility that matures in 2023;

the “2018 Term Loan” refer to the \$500 million term loan provided by the 2018 Credit Facility that matures in June 2021;

the “LLC Agreement” refer to the fifth amended and restated operating agreement of the Company dated as of December 6, 2016;

“we”, “us” and “our” refer to the Trust, the Company and the businesses together.

#### Statement Regarding Forward-Looking Disclosure

This Annual Report on Form 10-K, including the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business,” contains 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 Annual Report on Form 10-K 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 any future acquisitions;
- our ability to remove our Manager and our Manager’s right to resign;
- our trust and 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 our ability to make distributions in the future to our shareholders;
- our ability to pay the management fee, and profit allocation 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 our Manager’s ability to retain or replace qualified employees of our businesses and our Manager;
- 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. A description of some of the risks that could cause our actual results to differ appears under the section “Risk Factors”. 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 Annual Report on Form 10-K may not occur. These forward-looking statements are made as of the date of this Annual Report. We undertake no obligation to publicly update or revise any forward-looking statements to reflect subsequent events or circumstances, whether as a result of new information, future events or otherwise, except as required by law.

## PART I

### ITEM 1. BUSINESS

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 beneficial owners of 49.0% through Sostratus LLC of the Allocation Interests in us, as defined in our LLC Agreement.

#### Overview

We acquire controlling interests in and actively manage businesses that we believe (i) operate in industries with long-term macroeconomic growth opportunities, (ii) have positive and stable cash flows, (iii) face minimal threats of technological or competitive obsolescence, and (iv) have strong management teams largely in place.

Our unique public structure provides 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. Through the acquisition of a diversified group of businesses with these characteristics, we believe we offer investors an opportunity to diversify their own portfolio risk while participating in the ongoing cash flows of those businesses through the receipt of quarterly distributions.

Our disciplined approach to our target market provides opportunities to methodically purchase attractive businesses at values that are accretive to our shareholders. For sellers of businesses, our unique financial structure allows us to acquire businesses efficiently with little or no third party financing contingencies and, following acquisition, to provide our businesses with substantial access to growth capital.

We believe that private company operators and corporate parents looking to sell their business units may consider us an attractive purchaser because of our ability to:

- provide ongoing strategic and financial support for their businesses;
- maintain a long-term outlook as to the ownership of those businesses where such an outlook is required for maximization of our shareholders’ return on investment; and
- consummate transactions efficiently without being dependent on third-party transaction financing.

In particular, we believe that our outlook on length of ownership and active management on our part may alleviate the concern that many private company operators and parent companies may have with regard to their businesses going through multiple sale processes in a short period of time. We believe this outlook reduces both the risk that businesses may be sold at unfavorable points in the overall market cycle and enhances our ability to develop a comprehensive strategy to grow the earnings and cash flows of each of our businesses, which we expect will better enable us to meet our long-term objective of continuing to pay distributions to our shareholders while increasing shareholder value. Finally, it has been our experience, that our ability to acquire businesses without the cumbersome delays and conditions typical of third party transactional financing is appealing to sellers of businesses who are interested in confidentiality and certainty to close.

We believe our management team’s strong relationships with industry executives, accountants, attorneys, business brokers, commercial and investment bankers, and other potential sources of acquisition opportunities offer us substantial opportunities to assess small to middle market businesses available for acquisition. In addition, the flexibility, creativity, experience and expertise of our management team in structuring transactions allows us to consider non-traditional and complex transactions tailored to fit a specific acquisition target.



In terms of the businesses in which we have a controlling interest as of December 31, 2018, we believe that these businesses have strong management teams, operate in strong markets with defensible market niches and maintain long-standing customer relationships.

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

The following is a brief summary of the businesses in which we own a controlling interest at December 31, 2018:  
Branded Consumer Businesses

#### 5.11

5.11 ABR Corp. ("5.11 Tactical" or "5.11") is a leading provider of purpose-built tactical apparel and gear for law enforcement, firefighters, EMS, and military special operations as well as outdoor and adventure enthusiasts. 5.11 is a brand known for innovation and authenticity, and works directly with end users to create purpose-built apparel and gear designed to enhance the safety, accuracy, speed and performance of tactical professionals and enthusiasts worldwide. 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 approximately \$408.2 million in August 2016. We currently own 97.5% of the outstanding stock of 5.11 on a primary basis and 88.7% on a fully diluted basis.

#### Ergobaby

Ergobaby Carrier, Inc. ("Ergobaby"), headquartered in Los Angeles, California, is dedicated to building a global community of confident parents with smart, ergonomic solutions that enable and encourage bonding between parents and babies. Ergobaby offers a broad range of award-winning baby carriers, strollers, car seats, swaddlers, nursing pillows, and related products that fit into families' daily lives seamlessly, comfortably and safely. We made loans to, and purchased a controlling interest in, Ergobaby on September 16, 2010 for approximately \$85.2 million. We currently own 81.9% of the outstanding stock of Ergobaby on a primary basis and 76.4% on a fully diluted basis.

#### Liberty Safe

Liberty Safe and Security Products, Inc. ("Liberty Safe" or "Liberty"), headquartered in Payson, Utah, is a designer, manufacturer and marketer of premium home, office and gun safes in North America. From its over 300,000 square foot manufacturing facility, Liberty produces a wide range of home and gun safe models in a broad assortment of sizes, features and styles. We made loans to, and purchased a controlling interest in, Liberty Safe on March 31, 2010 for approximately \$70.2 million. We currently own 88.6% of the outstanding stock of Liberty Safe on a primary basis and 85.2% on a fully diluted basis.

#### Manitoba Harvest

Fresh Hemp Foods Ltd. ("Manitoba Harvest" or "Manitoba"), headquartered in Winnipeg, Manitoba, 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™, and Hemp protein powders, are currently carried in approximately 13,000 retail stores across the United States and Canada. We made loans to, and purchased a controlling interest in, Manitoba Harvest on July 10, 2015 for approximately \$102.7 million (C\$130.3 million). We currently own 76.6% of the outstanding stock of Manitoba Harvest on a primary basis and 68.1% on a fully diluted basis.

#### Velocity Outdoor

Velocity Outdoor Inc. ("Velocity Outdoor" or "Velocity") (formerly Crosman Corp.) is a leading designer, manufacturer, and marketer of airguns, archery products, laser aiming devices and related accessories. Velocity Outdoor offers its products under the highly recognizable Crosman, Benjamin, LaserMax, Ravin and CenterPoint brands that are available through national retail chains, mass merchants, dealer and distributor networks. The airgun product category





consists of air rifles, air pistols and a range of accessories including targets, holsters and cases. Velocity Outdoor's other primary product categories are archery, with products including CenterPoint crossbows and the Pioneer Airbow, consumables, which includes steel and plastic BBs, lead pellets and CO2 cartridges, lasers for firearms, and airsoft products. We made loans to, and purchased a controlling interest in, Velocity Outdoor on June 2, 2017 for approximately \$150.4 million. In September 2018, Velocity acquired Ravin Crossbows LLC ("Ravin" or "Ravin Crossbows"), a manufacturer and innovator of crossbows and accessories. Ravin primarily focuses on the higher-end segment of the crossbow market and has developed significant intellectual property related to the advancement of crossbow technology. Velocity Outdoor is headquartered in Bloomfield, New York. We currently own 99.2% of the outstanding stock of Velocity Outdoor on a primary basis and 91.0% on a fully diluted basis.

#### Niche Industrial Businesses

##### Advanced Circuits

Compass AC Holdings, Inc. ("Advanced Circuits" or "ACI"), headquartered in Aurora, Colorado, is a provider of small-run, quick-turn and volume production rigid printed circuit boards, or "PCBs", throughout the United States. PCBs are a vital component of virtually all electronic products. The small-run and quick-turn portions of the PCB industry are characterized by customers requiring high levels of responsiveness, technical support and timely delivery. We made loans to, and purchased a controlling interest in, Advanced Circuits, on May 16, 2006 for approximately \$81.0 million. We currently own 69.4% of the outstanding stock of Advanced Circuits on a primary basis and 69.2% on a fully diluted basis.

##### Arnold

AMT Acquisition Corp. ("Arnold") serves a variety of markets including aerospace and defense, motorsport/automotive, oil and gas, medical, general industrial, energy, reprographics and advertising specialties. Over the course of 100+ years, Arnold has successfully evolved and adapted our products, technologies, and manufacturing presence to meet the demands of current and emerging markets. Arnold produces high performance permanent magnets (PMAG), precision foil products (Precision Thin Metals or "PTM"), and flexible magnets (Flexmag™) that are mission critical in motors, generators, sensors and other systems and components. Arnold has expanded globally and built strong relationships with our customers worldwide. Arnold is the largest and, we believe, the most technically advanced U.S. manufacturer of engineered magnetic systems. Arnold is headquartered in Rochester, New York. We made loans to, and purchased a controlling interest in, Arnold on March 5, 2012 for approximately \$128.8 million. We currently own 96.7% of the outstanding stock of Arnold on a primary basis and 79.4% on a fully diluted basis.

##### Clean Earth

Clean Earth Holdings, Inc. ("Clean Earth"), headquartered in Hatboro, Pennsylvania, is a provider of environmental services for a variety of contaminated materials. Clean Earth provides a one-stop shop solution that analyzes, treats, documents and recycles waste streams generated in multiple end-markets such as utilities, infrastructure, chemicals, aerospace and defense, non-public/ private development, medical, industrial and dredging. We made loans to, and purchased a controlling interest in, Clean Earth on August 26, 2014 for approximately \$251.4 million. We currently own 97.5% of the outstanding stock of Clean Earth on a primary basis and 79.8% on a fully diluted basis.

##### Foam Fabricators

Foam Fabricators Inc. ("Foam Fabricators"), headquartered in Scottsdale, Arizona, is a designer and manufacturer of custom molded protective foam solutions and OEM components made from expanded polystyrene (EPS) and other expanded polymers. Foam Fabricators provides products to a variety of end-markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building products and others. Foam Fabricators' molded foam solutions offer shock and vibration protection, surface protection, temperature control, resistance to water absorption and vapor transmission and other protective properties critical for shipping small, delicate items, heavy equipment or temperature-sensitive goods. Foam Fabricators operates 13 molding and fabricating facilities across North America, creating a geographic footprint of strategically located manufacturing plants to efficiently serve national customer accounts. We acquired Foam Fabricators on February 15, 2018 for a purchase price of approximately \$253.4 million. We currently own 100.0% of the outstanding stock of Foam Fabricators on a primary basis and 91.5% on a fully diluted basis.



## Sterno

The Sterno Group LLC ("Sterno"), headquartered in Corona, California, is the parent company of Sterno Products, LLC ("Sterno Products"), Sterno Home Inc. ("Sterno Home"), and Rimports, LLC. Sterno is a leading manufacturer and marketer of portable food warming fuels for the hospitality and consumer markets, flameless candles and house and garden lighting for the home decor market, and wickless candle products used for home decor and fragrance systems. We made loans to, and purchased all of the equity interests in, Sterno on October 10, 2014 for approximately \$160.0 million. Sterno offers a broad range of wick and gel chafing fuels, butane stoves and accessories, liquid and traditional wax candles, catering equipment and lamps through their Sterno Products division. In January 2016, Sterno acquired Northern International, Inc. ("Sterno Home"), which sells flameless candles and outdoor lighting products through the retail segment, and in February 2018, Sterno acquired Rimports, Inc. ("Rimports"), which is a manufacturer and distributor of branded and private label scented wax cubes and warmer products used for home decor and fragrance systems. We currently own 100.0% of the outstanding stock of Sterno on a primary basis and 88.9% on a fully diluted basis.

Our businesses also represent our operating segments. See "Our Businesses" and "Note E – Operating Segment Data" to our Consolidated Financial Statements for further discussion of our businesses as our operating segments, including information related to geographies.

### 2018 Highlights and Recent Events

#### 2018 Acquisitions

##### Acquisition of Foam Fabricators

On February 15, 2018, the Company, through our wholly owned subsidiary FFI Compass, Inc., acquired all of the issued and outstanding capital stock of Foam Fabricators, Inc., a Delaware corporation ("Foam Fabricators"), for a purchase price of approximately \$253.4 million. Foam Fabricators is a leading designer and manufacturer of custom molded protective foam solutions and OEM components made from expanded polymers such as expanded polystyrene and expanded polypropylene. Founded in 1957 and headquartered in Scottsdale, Arizona, it operates 13 molding and fabricating facilities across North America and provides products to a variety of end-markets, including appliances and electronics, pharmaceuticals, health and wellness, automotive, building products and others.

##### Acquisition of Rimports

On February 26, 2018, our Sterno subsidiary acquired all of the issued and outstanding capital stock of Rimports, Inc., a Utah corporation, pursuant to a Stock Purchase Agreement, dated January 23, 2018. Sterno purchased a 100% controlling interest in Rimports. Headquartered in Provo, Utah, Rimports is a manufacturer and distributor of branded and private label scented wickless candle products used for home décor and fragrance. Rimports offers an extensive line of wax warmers, scented wax cubes, essential oils and diffusers, and other home fragrance systems, through the mass retailer channel. The purchase price, net of transaction costs, was approximately \$154.4 million. The purchase price of Rimports includes a potential earn-out of up to \$25 million contingent on the attainment of certain future performance criteria of Rimports. Sterno funded the acquisition through their intercompany credit facility with the Company.

##### Acquisition of ESMI

On May 23, 2018, Clean Earth acquired all of the outstanding capital stock of Environmental Soil Management, Inc. ("ESMI"), located in Fort Edward, New York and Loudon, New Hampshire. The acquisition provided Clean Earth the opportunity to geographically expand their soil and hazardous waste solutions in the New York and New England market. The purchase price was approximately \$31.0 million.

##### Acquisition of Ravin Crossbows

On September 4, 2018, Velocity Outdoor (formerly "Crosman Corp.") acquired all of the outstanding membership interests in Ravin for a purchase price of approximately \$98.0 million, net of transaction costs, plus a potential earn-out of up to \$25.0 million based on gross profit levels as of December 31, 2018. Headquartered in Superior, Wisconsin, Ravin Crossbows is a leading designer, manufacturer and innovator of crossbows and accessories. Ravin primarily focuses on the higher-end segment of the crossbow market and has developed significant intellectual property related to the advancement of crossbow technology. The acquisition of Ravin positions Velocity Outdoor to more fully capitalize on the sizeable crossbow market, further diversify its customer base and take advantage of the product and market expertise inside of Ravin.



### Senior Notes and 2018 Credit Facility

On April 18, 2018, we consummated the issuance and sale of \$400 million aggregate principal amount of our 8.000% Senior Notes due 2026 (the "Notes" or "Senior Notes") offered pursuant to a private offering. We used the net proceeds from the sale of the Notes to repay debt under our existing credit facilities in connection with a concurrent refinancing of our 2014 Credit Facility. The Notes will bear interest at the rate of 8.000% per annum and will mature on May 1, 2026. Interest on the Notes is payable in cash on May 1st and November 1st of each year, beginning on November 1, 2018. The Notes are general senior unsecured obligations and are not guaranteed by our subsidiaries.

Concurrent with the issuance of the Notes, we entered into an Amended and Restated Credit Agreement (the "2018 Credit Facility") to amend and restate the 2014 Credit Facility, originally dated as of June 6, 2014 (as previously amended) among the Company, the lenders from time to time party thereto (the "Lenders"), and Bank of America, N.A., as Administrative Agent. The 2018 Credit Facility provides for (i) revolving loans, swing line loans and letters of credit (the "2018 Revolving Credit Facility") up to a maximum aggregate amount of \$600 million, and (ii) a \$500 million term loan (the "2018 Term Loan"). The 2018 Term Loan was issued at an original issuance discount of 99.75%. We used the proceeds from the 2018 Credit Facility and the proceeds from the Notes offering to pay all amounts outstanding under our existing credit agreement and to pay the fees, original issue discount and expenses incurred in connection with the 2018 Credit Facility and Notes.

### Trust Preferred Share Issuance

On March 13, 2018, the Trust issued 4,000,000 7.875% Series B Preferred Shares (the "Series B Preferred Shares") for gross proceeds of \$100.0 million, or \$96.5 million net of underwriters' discount and issuance costs. Distributions on the Series B Preferred Shares will be payable quarterly in arrears, when and as declared by the Company's board of directors on January 30, April 30, July 30, and October 30 of each year, beginning on July 30, 2018. Distributions on the Series B Preferred Shares are cumulative.

### 2018 Distributions

Common shares - For the 2018 fiscal year we declared distributions to our common shareholders totaling \$1.44 per share.

Preferred shares - For the 2018 fiscal year we declared distributions to our preferred shareholders totaling \$1.8125 per share on our Series A Preferred Shares and \$1.724375 per share on our Series B Preferred Shares.

### Subsequent Events

#### Manitoba Harvest

On February 19, 2019, we entered into a definitive agreement (the "Agreement") with Tilray, Inc. ("Tilray") and a wholly-owned subsidiary of Tilray, 1197879 B.C. Ltd. ("Tilray Subco"), to sell to Tilray, Inc., through Tilray Subco, all of the issued and outstanding securities of Manitoba Harvest for total consideration of up to C\$419 million. Subject to certain customary adjustments, the shareholders of Manitoba Harvest, including the Company, may receive the following from Tilray as consideration for their shares of Manitoba Harvest: (i) C\$150 million in cash to the holders of preferred shares of Manitoba Harvest and the holders of common shares of Manitoba Harvest ("Common Holders") and C\$127.5 million in shares of class 2 Common Stock of Tilray ("Common Stock") to the Common Holders on the closing date of the sale (the "Closing Date Consideration"), (ii) C\$50 million in cash and C\$42.5 million in Common Stock to the Common Holders on the date that is six months after the closing date of the Arrangement (the "Deferred Consideration") and (iii) C\$49 million in Common Stock to the Common Holders, which amount may be reduced, potentially to zero, if Manitoba Harvest fails to attain certain levels of U.S. branded gross sales of edible or topical products containing broad spectrum hemp extracts or cannabidiols prior to December 31, 2019. The cash portion of the Closing Date Consideration will be reduced by the amount of the net indebtedness of Manitoba Harvest on the closing date and transaction expenses expected to be approximately \$5 million. The Common Stock consideration is expected to be issued in reliance on the exemption from the registration requirements of the U.S. Securities Act and pursuant to exemptions from applicable securities laws of any state of the United States, such that any shares of Common Stock received by the Common Holders will be freely tradeable. The sale of Manitoba Harvest will occur pursuant to a plan of arrangement under the Business Operations Act (British Columbia). The completion of the plan of arrangement is subject to approval by the British Columbia Supreme Court. The sale is expected to close as soon as practicable following receipt of court approval.



### Tax Reporting

Information returns will be filed by the Trust and the Company with the Internal Revenue Service ("IRS"), as required, with respect to income, gain, loss, deduction and other items derived from the Company's activities. The Company has and will file a partnership return with the IRS and intends to issue a Schedule K-1 to the trustee. The trustee intends to provide information to each holder of shares using a monthly convention as the calculation period. For 2018 and future years, the Trust will continue to file a Form 1065 and issue Schedule K-1 to shareholders. For 2018, we delivered the Schedule K-1 to shareholders within the same time frame as we delivered the schedule to shareholders for the 2017 and 2016 taxable years. The relevant and necessary information for tax purposes is readily available electronically through our website. Each holder will be deemed to have consented to provide relevant information, and if the shares are held through a broker or other nominee, to allow such broker or other nominee to provide such information as is reasonably requested by us for purposes of complying with our tax reporting obligations.

### WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file reports with the Securities and Exchange Commission (the "SEC" or the "Commission"), including Forms S-1 and S-3 under the Securities Act of 1933, as amended (the "Securities Act"), and Forms 10-K, 10-Q, and 8-K under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), which include exhibits, schedules and amendments to those reports, as well as other filings required by the SEC. The public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at <http://www.sec.gov>. In addition, copies of such reports are available free of charge through our website at <http://www.compassdiversifiedholdings.com> as soon as reasonably practicable after such documents are electronically filed with, or furnished to, the SEC.



Organizational Structure <sup>(1)</sup>

1) The percentage holdings shown in respect to the trust reflect the ownership of the Trust common shares as of December 31, 2018.

Our non-affiliated holders of common shares own approximately 84.0% of the Trust common shares and CGI Maygar Holdings, LLC owns approximately 13.4% of the Trust common shares and is our single largest holder.

2) Path Spirit Limited is the ultimate controlling person of CGI Maygar LLC. Mr. Sabo, our Chief Executive Officer, is not a director, officer or member of CGI or any of its affiliates. The remaining 2.6% of Trust common shares are owned by our Directors and Officers.

49.0% beneficially owned by certain persons who are employees and partners of our Manager. C. Sean Day, the Chairman of our Board of Directors, CGI and the former founding partners of the Manager, are non-managing members.

4) Mr. Sabo is a partner of this entity.

5) The Allocation Interests, which carry the right to receive a profit allocation, represent less than 0.1% equity interest in the Company.

Our Manager

Our Manager, CGM, has been engaged to manage the day-to-day operations and affairs of the Company and to execute our strategy, as discussed below. Collectively, our management team has extensive experience in acquiring and managing small and middle market businesses. We believe our Manager is unique in the marketplace in terms of the success and experience of its employees in acquiring and managing diverse businesses of the size and general nature of our businesses. We believe this experience will provide us with an advantage in executing our overall strategy. Our management team devotes a majority of its time to the affairs of the Company.

We have entered into a management services agreement, (the “Management Services Agreement” or “MSA”) pursuant to which our Manager manages the day-to-day operations and affairs of the Company and oversees the management and operations of our businesses. We pay our Manager a quarterly management fee for the services it performs on our behalf. In addition, certain persons who are employees and partners of our Manager receive a profit allocation with respect to its Allocation Interests in us. All of the Allocation Interests in us are owned by Sostratus LLC. See Part III, Item 13 “Certain Relationships and Related Transactions” for further descriptions of the management fees and profit allocations.

The Company’s Chief Executive Officer and Chief Financial Officer are employees of our Manager and have been seconded to us. Neither the Trust nor the Company has any other employees. Although our Chief Executive Officer and Chief Financial Officer are employees of our Manager, they report directly to the Company’s board of directors. The management fee paid to our Manager covers all expenses related to the services performed by our Manager, including the compensation of our Chief Executive Officer and other personnel providing services to us. The Company reimburses our Manager for the compensation and related costs and expenses of our Chief Financial Officer and his staff, who dedicate substantially all of their time to the affairs of the Company.

See Part III, Item 13, “Certain Relationships and Related Party Transactions and Director Independence.”

#### Market Opportunity

We acquire and actively manage small and middle market businesses. We characterize small to middle market businesses as those that generate annual cash flows of up to \$60 million. We believe that the merger and acquisition market for small to middle market businesses is highly fragmented and provides opportunities to purchase businesses at attractive prices. We believe that the following factors contribute to lower acquisition multiples for small and middle market businesses:

- there are fewer potential acquirers for these businesses;
- third-party financing generally is less available for these acquisitions;
- sellers of these businesses frequently consider non-economic factors, such as continuing board membership or the effect of the sale on their employees; and
- these businesses are less frequently sold pursuant to an auction process.

Frequently, opportunities exist to augment existing management at such businesses and improve the performance of these businesses upon their acquisition. In the past, our management team has acquired businesses that were owned by entrepreneurs or large corporate parents. In these cases, our management team has frequently found that there have been opportunities to further build upon the management teams of acquired businesses beyond those that existed at the time of acquisition. In addition, our management team has frequently found that financial reporting and management information systems of acquired businesses may be improved, both of which can lead to improvements in earnings and cash flow. Finally, because these businesses tend to be too small to have their own corporate development efforts, opportunities frequently exist to assist these businesses as they pursue organic or external growth strategies that were often not pursued by their previous owners.

#### Our Strategy

We have two primary strategies that we use in order to provide distributions to our shareholders and increase shareholder value. First, we focus on growing the earnings and cash flow from our acquired businesses. We believe that the scale and scope of our businesses give us a diverse base of cash flow upon which to further build. Second, we identify, perform due diligence on, negotiate and consummate additional platform acquisitions of small to middle market businesses in attractive industry sectors in accordance with acquisition criteria established by the board of directors.

#### Management Strategy

Our management strategy involves the proactive financial and operational management of the businesses we own in order to increase cash flow, pay distributions to our shareholders and increase shareholder value. Our Manager oversees and supports the management teams of each of our businesses by, among other things:

- recruiting and retaining talented managers to operate our businesses using structured incentive compensation programs, including non-controlling equity ownership, tailored to each business;



- 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 growth strategies;
- identifying and working with management to execute attractive external growth and acquisition opportunities;
- assisting management in controlling and right-sizing overhead costs; and
- forming strong subsidiary level boards of directors to supplement management in their development and implementation of strategic goals and objectives.

Specifically, while our businesses have different growth opportunities and potential rates of growth, we expect our Manager to work with the management teams of each of our businesses to increase the value of, and cash generated by, each business through various initiatives, including:

- making selective capital investments to expand geographic reach, increase capacity, or reduce manufacturing costs of our businesses;
- investing in product research and development for new products, processes or services for customers;
- improving and expanding existing sales and marketing programs;
- pursuing reductions in operating costs through improved operational efficiency or outsourcing of certain processes and products; and
- consolidating or improving management of certain overhead functions.

Our businesses typically acquire and integrate complementary businesses. We believe that complementary add-on acquisitions improve our overall financial and operational performance by allowing us to:

- leverage manufacturing and distribution operations;
- leverage branding and marketing programs, as well as customer relationships;
- add experienced management or management expertise;
- increase market share and penetrate new markets; and
- realize cost synergies by allocating the corporate overhead expenses of our businesses across a larger number of businesses and by implementing and coordinating improved management practices.

We incur third party debt financing almost entirely at the Company level, which we use, in combination with our equity capital, to provide debt financing to each of our businesses and to acquire additional businesses. We believe this financing structure is beneficial to the financial and operational activities of each of our businesses by aligning our interests as both equity holders of, and lenders to, our businesses, in a manner that we believe is more efficient than each of our businesses borrowing from third-party lenders.

#### Acquisition Strategy

Our acquisition strategy involves the acquisition of businesses that we expect to produce stable and growing earnings and cash flow. In this respect, we expect to make acquisitions in industries other than those in which our businesses currently operate if we believe an acquisition presents an attractive opportunity. We believe that attractive opportunities will continue to present themselves, as private sector owners seek to monetize their interests in long-standing and privately-held businesses and large corporate parents seek to dispose of their “non-core” operations.

Our ideal acquisition candidate has the following characteristics:

- is an established North American based company;
- maintains a significant market share in defensible industry niche (i.e., has a “reason to exist”);
- has a solid and proven management team with meaningful incentives;
- has low technological and/or product obsolescence risk; and
- maintains a diversified customer and supplier base.

We benefit from our Manager’s ability to identify potential diverse acquisition opportunities in a variety of industries. In addition, we rely upon our management team’s experience and expertise in researching and valuing prospective target businesses, as well as negotiating the ultimate acquisition of such target businesses. In particular, because there may be a lack of information available about these target businesses, which may make it more difficult to understand or appropriately value such target businesses, on our behalf, our Manager:



- engages in a substantial level of internal and third-party due diligence;
- critically evaluates the target management team;
- identifies and assesses any financial and operational strengths and weaknesses of the target business;
- analyzes comparable businesses to assess financial and operational performances relative to industry competitors;
- actively researches and evaluates information on the relevant industry; and
- thoroughly negotiates appropriate terms and conditions of any acquisition.

The process of acquiring new businesses is both time-consuming and complex. Our management team historically has taken from two to twenty-four months to perform due diligence, negotiate and close acquisitions. Although our management team is always at various stages of evaluating several transactions at any given time, there may be periods of time during which our management team does not recommend any new acquisitions to us. Even if an acquisition is recommended by our management team, our board of directors may not approve it.

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 company level largely through our existing credit facility, to close acquisitions. We believe, and it has been our experience, that having the ability to finance our acquisitions with capital resources raised by us, rather than negotiating separate third party financing, provides us with an advantage in successfully acquiring attractive businesses by minimizing delay and closing conditions that are often related to acquisition-specific financings. In addition, our strategy of providing this intercompany debt financing within the capital structure of the businesses we acquire and manage allows us the ability to distribute cash to the parent company through monthly interest payments and amortization of principle on these intercompany loans. Upon acquisition of a new business, we rely on our Manager's experience and expertise to work efficiently and effectively with the management of the new business to jointly develop and execute a successful business plan. We believe our financing structure, in which both equity and debt capital are raised at the Company level, allows us to acquire businesses without transaction specific financing and is conducive to our ability to consummate transactions that may be attractive in both the short and long-term.

In addition to acquiring businesses, we sell those businesses that we own from time to time when attractive opportunities arise that outweigh the future growth and value that we believe we will be able to bring such businesses consistent with our long-term investment strategy. As such, our decision to sell a business is based on our belief that doing so will increase shareholder value to a greater extent than through our continued ownership of that business. Upon the sale of a business, we may use the proceeds to retire debt or retain proceeds for acquisitions or general corporate purposes. We do not expect to make special distributions at the time of a sale of one of our businesses; instead, we expect to pay shareholder distributions over time solely through the earnings and cash flows of our businesses.

Since our inception in May 2006, we have recorded net gains on sales of our businesses of approximately \$772 million. We sold Crosman Acquisition Company ("Crosman") in January 2007, Aeroglide Company ("Aeroglide") and Silvue Technologies Group, Inc. ("Silvue") in June 2008, Staffmark Holdings Inc. ("Staffmark") in October 2011, HALO Branded Solutions ("HALO") in May 2012, CamelBak Products, LLC ("CamelBak") in August 2015, American Furniture Manufacturing, Inc. ("American Furniture") in October 2015, and Tridien Medical Inc. ("Tridien") in September 2016. In addition, we sold our Fox Factory Holding Corp. ("FOX") subsidiary through an initial public offering and secondary issuances from August 2013 through March 2017. We sold our Manitoba Harvest Business in February 2019 and anticipate recording a gain on sale during the first quarter of 2019.

#### Investment in FOX

We made loans to and purchased a controlling interest in FOX on January 4, 2008, for approximately \$80.4 million. In August 2013, FOX completed an initial public offering of its common stock. As a result of the initial public offering, our ownership interest in FOX was reduced to approximately 53.9%. No gain was reflected as a result of the sale of our FOX shares in the initial public offering because our majority classification of FOX did not change. FOX used a portion of their net proceeds received from the sale of their shares as well as proceeds from a new external FOX credit facility to repay \$61.5 million in outstanding indebtedness to us under their existing credit facility with us. In July 2014, through a secondary offering, our ownership in FOX was lowered from approximately 53% to approximately 41%, and as a result we deconsolidated FOX as of July 10, 2014. In March and August 2016, through two more secondary offerings and a share repurchase by FOX, our ownership in the outstanding common stock of FOX was

further lowered to approximately 23% as of September 30, 2016. In November 2016, through another secondary offering, our ownership

in the outstanding common stock of FOX was further lowered to approximately 14%. On March 13, 2017, FOX closed on a secondary public offering of 5,108,718 shares of FOX common stock held by CODI, which represented CODI's remaining investment in FOX. CODI received \$136.1 million in net proceeds as a result of the sale. We recognized total net proceeds from the sales of our FOX shares of approximately \$465.1 million, and a total gain of \$428.7 million.

#### Strategic Advantages

Based on the experience of our management team and its ability to identify and negotiate acquisitions, we believe we are well-positioned to acquire additional businesses. Our management team has strong relationships with business brokers, investment and commercial bankers, accountants, attorneys and other potential sources of acquisition opportunities. In addition, our management team also has a successful track record of acquiring and managing small to middle market businesses in various industries. In negotiating these acquisitions, we believe our management team has been able to successfully navigate complex situations surrounding acquisitions, including corporate spin-offs, transitions of family-owned businesses, management buy-outs and reorganizations.

Our management team has a large network that we estimate to be approximately 2,000 deal intermediaries who we expect to expose us to potential acquisitions. Through this network, as well as our management team's proprietary transaction sourcing efforts, we have a substantial pipeline of potential acquisition targets. Our management team also has a well-established network of contacts, including professional managers, attorneys, accountants and other third-party consultants and advisors, who may be available to assist us in the performance of due diligence and the negotiation of acquisitions, as well as the management and operation of our acquired businesses.

Finally, because we intend to fund acquisitions through the utilization of our 2014 Revolving Credit Facility, we expect to minimize the delays and closing conditions typically associated with transaction specific financing, as is typically the case in such acquisitions. We believe this advantage can be a powerful one, especially in a tight credit environment, and is highly unusual in the marketplace for acquisitions in which we operate.

#### Valuation and Due Diligence

When evaluating businesses or assets for acquisition, our management team performs a rigorous due diligence and financial evaluation process. In doing so, we evaluate the operations of the target business as well as the outlook for the industry in which the target business operates. While valuation of a business is, by definition, a subjective process, we define valuations under a variety of analyses, including:

- discounted cash flow analyses;
- evaluation of trading values of comparable companies;
- expected value matrices; and
- examination of comparable recent transactions.

One outcome of this process is a projection of the expected cash flows from the target business. A further outcome is an understanding of the types and levels of risk associated with those projections. While future performance and projections are always uncertain, we believe that with detailed due diligence, future cash flows will be better estimated and the prospects for operating the business in the future better evaluated. To assist us in identifying material risks and validating key assumptions in our financial and operational analysis, in addition to our own analysis, we engage third-party experts to review key risk areas, including legal, tax, regulatory, accounting, insurance and environmental. We also engage technical, operational or industry consultants, as necessary.

A further critical component of the evaluation of potential target businesses is the assessment of the capability of the existing management team, including recent performance, expertise, experience, culture and incentives to perform. Where necessary, and consistent with our management strategy, we actively seek to augment, supplement or replace existing members of management who we believe are not likely to execute our business plan for the target business. Similarly, we analyze and evaluate the financial and operational information systems of target businesses and, where necessary, we enhance and improve those existing systems that are deemed to be inadequate or insufficient to support our business plan for the target business.

#### Financing

##### Credit Facility

In April 2018, we entered into the 2018 Credit Facility to amend and restate the 2014 Credit Facility, originally dated as of June 6, 2014. The 2018 Credit Facility provides for (i) revolving loans, swing line loans and letters of credit up





to a maximum aggregate amount of \$600 million (the “2018 Revolving Loan Commitment”), and (ii) a \$500 million term loan.

At December 31, 2018, we had \$496.3 million outstanding on the 2018 Term Loan and \$228.0 million outstanding on our 2018 Revolving Credit Facility. All amounts outstanding under the 2018 Revolving Credit Facility will become due on April 18, 2023, which is the maturity date of loans advanced under the 2018 Revolving Credit Facility and the termination date of the revolving loan commitment. The 2018 Credit Facility also permits us, prior to the applicable maturity date, to increase the revolving loan commitment and/or obtain additional term loans in an aggregate amount of up to \$250 million subject to certain restrictions and conditions.

The 2018 Credit Facility provides for letters of credit under the 2018 Revolving Credit Facility in an aggregate face amount not to exceed \$100 million outstanding at any time, as well as swing line loans of up to \$25 million outstanding at one time. At no time may the (i) aggregate principal amount of all amounts outstanding under the Revolving Credit Facility, plus (ii) the aggregate amount of all outstanding letters of credit and swing line loans, exceed the borrowing availability under the 2014 Credit Facility. At December 31, 2018, we had outstanding letters of credit totaling approximately \$0.3 million. The borrowing availability under the 2018 Revolving Credit Facility at December 31, 2018 was approximately \$371.7 million.

The 2018 Credit Facility is secured by all of the assets of the Company, including all of its equity interests in, and loans to, its consolidated subsidiaries. (See “Note H - Debt” to the consolidated financial statements for more detail regarding our 2018 Credit Facility).

#### Senior Notes

On April 18, 2018, we consummated the issuance and sale of \$400 million aggregate principal amount of our Senior Notes offered pursuant to a private offering to qualified institutional buyers in accordance with Rule 144A under the Securities Act, and to non-U.S. persons under Regulation S under the Securities Act. We used the net proceeds from the sale of the Notes to repay debt under our existing credit facilities in connection with a concurrent refinancing transaction described above. The Notes were issued pursuant to an indenture, dated as of April 18, 2018 (the “Indenture”), between the Company and U.S. Bank National Association, as trustee. The Notes will bear interest at the rate of 8.000% per annum and will mature on May 1, 2026. Interest on the Notes is payable in cash on May 1st and November 1st of each year, beginning on November 1, 2018. The Notes are general senior unsecured obligations of the Company and are not guaranteed by our subsidiaries.

We intend to finance future acquisitions through our 2018 Revolving Credit Facility, cash on hand and, if necessary, additional equity and debt financings. We believe, and it has been our experience, that having the ability to finance our acquisitions with the capital resources raised by us, rather than negotiating separate third party financing specifically related to the acquisition of individual businesses, provides us with an advantage in acquiring attractive businesses by minimizing delay and closing conditions that are often related to acquisition-specific financings. In this respect, we believe that in the future, we may need to pursue additional debt or equity financings, or offer equity in Holdings or target businesses to the sellers of such target businesses, in order to fund multiple future acquisitions.

#### Our Businesses

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

The following table represents the percentage of net revenue and operating income each of our businesses contributed to our consolidated results since the date of acquisition for the years ended December 31, 2018, 2017 and 2016, and the total assets of each of our businesses as a percentage of the consolidated total as of December 31, 2018 and 2017.

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	Year ended December 31,			Year ended December 31,			Year ended December 31,		
	2018	2017	2016	2018	2017	2016	2018	2017	2016
	Net Revenue			Operating Income <sup>(1)</sup>			Total Assets		
Branded Consumer:									
5.11	20.6	% 24.4	% 11.2	% 3.2	% (10.5)	% (17.8)	% 19.8	% 26.1	%
Ergobaby	5.4	% 8.1	% 10.6	% 9.4	% 36.1	% 30.0	% 7.2	% 9.8	%
Liberty Safe	4.9	% 7.2	% 10.6	% 4.8	% 13.9	% 23.2	% 3.0	% 4.0	%
Manitoba Harvest	4.0	% 4.4	% 6.1	% (1.4)	% (13.7)	% 0.6	% 5.5	% 7.8	%
Velocity Outdoor	7.8	% 6.2	% n/a	4.0	% 1.9	% n/a	12.3	% 10.9	%
	42.6	% 50.3	% 38.5	% 20.0	% 27.7	% 36.0	% 47.8	% 58.6	%
Niche Industrial:									
Advanced Circuits	5.5	% 6.9	% 8.8	% 21.5	% 34.7	% 39.8	% 3.4	% 4.4	%
Arnold Magnetics	7.0	% 8.3	% 11.1	% 6.1	% (8.4)	% (22.6)	% 4.6	% 6.0	%
Clean Earth	15.8	% 16.6	% 19.3	% 11.8	% 17.7	% 13.9	% 17.2	% 19.4	%
Foam Fabricators	6.7	% n/a	n/a	9.0	% n/a	n/a	10.6	% n/a	%
Sterno	22.5	% 17.8	% 22.4	% 31.7	% 28.2	% 32.9	% 15.9	% 11.2	%
	57.4	% 49.7	% 61.5	% 80.0	% 72.3	% 64.0	% 51.8	% 41.0	%
Corporate	—	—	—	—	—	—	0.4	% 0.5	%
	100.0	% 100.0	% 100.0	% 100.0	% 100.0	% 100.0	% 100.0	% 100.0	%

<sup>(1)</sup> Operating income (loss) reflected is as a percentage of the total contributed by the businesses and does not include expenses incurred at the corporate level.

Branded Consumer Businesses

5.11

Overview

5.11 is a leading provider of purpose-built tactical apparel and gear for law enforcement, firefighters, EMS, and military special operations as well as outdoor and adventure enthusiasts. 5.11 is committed to product innovation, and works directly with end users to create 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. 5.11 products are widely distributed in law enforcement dealers, uniform stores, military exchanges, outdoor retail stores, company owned retail stores and online.

History of 5.11

5.11 was formed in 2003 after spinning out of outdoor apparel company, Royal Robbins®. The roots of 5.11, however, trace back to 1975, when American rock climber Royal Robbins designed the 5.11® Pant; named after the difficulty level in the Yosemite Decimal System rating scale for rock climbing. With difficulty levels ranging at the time from 5.0 (easy) to 5.10 (difficult), 5.11 was then described: “After thorough inspection, you conclude this move is impossible; however, occasionally someone actually accomplishes it.”

A product designed for people who were pushing the limits of what was possible, the 5.11® Pant was a success among climbers and outdoor enthusiasts. In 1992, the FBI Academy, in Quantico, Virginia adopted the original 5.11® Pant as its primary training pant, forging a decades-long relationship that supports 5.11’s commitment to the public safety and the first responder communities.

In 2011, 5.11’s corporate headquarters was relocated from Modesto, California to Irvine, California. In 2012, 5.11 acquired Beyond Clothing LLC, a technical survival systems outerwear company located in Seattle, Washington. We acquired a majority interest in 5.11 on August 31, 2016.

## Industry

5.11 participates in the global professional and consumer soft goods market for tactical gear and apparel; the addressable global soft goods market is estimated by management to be approximately \$79 billion.

The domestic professional public safety market for tactical soft goods is estimated by management to be a \$1.7 billion market consisting of sales to active-duty military, law enforcement, private security, fire, corrections officers and EMS. The addressable domestic work wear and consumer wear markets are estimated by management to be \$4.3 billion and \$13.2 billion, respectively.

The international professional public safety market for tactical soft goods is estimated by management to be a \$11.7 billion market. The addressable international work wear and consumer wear markets are estimated by management to be \$11.4 billion and \$36.3 billion, respectively.

## Products and Services

5.11 offers a portfolio of unique head-to-toe tactical gear with patented functional features for both professional and consumer use. No individual product style accounts for more than 7% of total sales, and most product styles tend to have multi-year lifecycles. 5.11 focuses its product offering through six major categories: tactical apparel, bags and packs, footwear, special make ups/uniforms, accessories, and Beyond Clothing Systems (“Beyond”).

Tactical apparel represents 5.11’s largest product category. Within this category, 5.11 offers a broad assortment of men’s and women’s pants, shorts, shirts, outerwear and base layers. Apparel is offered in a variety of styles and fits intended to enhance comfort and mobility. 5.11 has historically designed and developed innovative “families” of products around proprietary fabrics that the company has created to meet the needs of its unique target market. These product “families” typically start with a pant and then expand into other products. Today, 5.11 offers five distinct pant lines, which anchor five different apparel families: the Defender Flex Pant, the Apex<sup>™</sup> Pant, the 5.11 Stryke<sup>™</sup> Pant, the Taclite<sup>®</sup> Pro Pant, and the 5.11<sup>®</sup> Tactical Pant.

5.11 bags and packs provide reliable, multifunctional storage options designed to excel in a wide range of operational and recreational settings. This category includes backpacks, cases, load-bearing equipment, range bags and duffels. In addition to bags/packs and apparel, 5.11 sells footwear, including boots, low-profile tactical shoes, socks and accessories, as well as special make ups or customized uniforms for public safety agencies. 5.11 also offers a wide selection of accessories including belts, hats, flashlights, gloves, knives, eyewear, watches, patches, slings and holsters.

Beyond, a wholly-owned subsidiary of 5.11, offers technical survival outerwear systems engineered specifically for missions in extreme temperatures. Products are marketed under the Beyond brand name and include base layers and briefs, pullovers, softshell jackets, wind pants, rain pants and jackets made of advanced fabrics. Virtually all Beyond products are manufactured in the United States to comply with the Berry Amendment.

5.11’s core product offerings and suggested average retail prices are listed below:

☛Pants and Shorts (Men’s and Women’s) - \$49.99 to \$269.99

☛Woven Tops (Men’s and Women’s) - \$39.99 to \$229.99

☛Outerwear (Men’s and Women’s) - \$69.99 to \$119.99

☛Footwear (Men’s and Women’s) - \$99.99 to \$149.99

☛Bags and Packs - \$59.99 to \$249.99

☛Accessories - \$19.99 to \$79.99

## Competitive Strengths

**Leading Brand Recognition and Market Share** - 5.11 is a leader in the tactical apparel market. 5.11 enjoys strong brand awareness and affinity in the public safety market given its long history of creating high performance and innovative products for public safety operators. 5.11’s heritage of developing purpose-built clothing and gear for law enforcement, firefighters, EMS, and military special operations has imbued the 5.11 brand with unrivaled authenticity in the tactical apparel and gear markets.

**Diverse Customer Base** - 5.11 has direct relationships with over 12,500 governmental departments and agencies, and utilizes an established network of over 1,500 dealers in over 90 countries. 5.11 wins a significant amount of

business in the public safety channel through the achievement of “specified” product in thousands of individual contracts with governmental departments and agencies, providing for a broad base of long-term relationships. Product Breadth and “At-Once” Availability - Requirements of outfitting entire agencies or departments necessitates carrying numerous, often infrequently used, sizes and colors of a given product. These requirements, coupled with “at-once” product fulfillment demands and often poorly capitalized dealer customers carrying low levels of inventory, makes 5.11 the go-to provider of tactical gear and apparel. 5.11’s significant investment in inventory provides a competitive advantage versus its smaller less well capitalized competitors.

#### Business Strategies

Further Expand into Consumer Market - 5.11 is well-positioned to continue investing in retail locations throughout the United States. 5.11 currently has forty-five company-owned retail locations, and management believes that there are significant opportunities to increase this footprint. 5.11 also sells to many outdoor specialty retailers and management believes there are opportunities to expand sales through increased penetration and improved merchandising.

Continue Penetration of Domestic Professional Channel - 5.11 continues to benefit from the domestic professional public safety market, which provides a stable base of recurring growth. Going forward, 5.11 will continue to grow within the domestic professional public safety channel through (i) continued conversion of institutional contract opportunity pipeline; and (ii) market share gains from continued product innovation and improved merchandising.

International Market Expansion - The international market remains an under-penetrated opportunity for 5.11. 5.11 will continue international sales development through building country-specific sales and operations infrastructure, executing on both near and medium term large foreign government contract opportunities, and expanding consumer awareness of the 5.11 brand.

#### Customers and Distribution Channels

5.11 services a wide range of customers including first responders, the military, and outdoors enthusiasts in over 90 countries. The primary distribution channels can be segmented into two categories: professional and consumer. 5.11’s working capital needs do not differ substantially from those of its competitors in the industry and generally reflect the need to carry significant amounts of inventory to meet the requirements of its customers.

The domestic professional channel is characterized by thousands of unique “specified” product contracts with individual public safety departments, serviced through a network of more than one-thousand local third party dealers. Public safety departments include federal, state, county, city and local law enforcement, firefighters, and EMS. Similar to the domestic professional channel, the international professional channel also consists of many unique “specified” product contracts with individual foreign governmental departments, serviced either directly by 5.11 or through a network of international dealers. Large contracts with government agencies are referred to as Direct-to-Agency (“DTA”). A typical DTA sales process is driven primarily by lengthy governmental approval processes and can take upwards of 18 to 36 months.

Within the consumer segment, the consumer wholesale channel is comprised of (i) outdoor specialty retailers, (ii) military exchanges, and (iii) online. The consumer direct channel is comprised of (i) e-commerce sales directly through the 5.11 website, [www.511tactical.com](http://www.511tactical.com), and (ii) company-owned retail stores. At the end of 2018, 5.11 operated forty-five company-owned retail locations in twenty-two states.

For the year ended December 31, 2018, professional channel sales accounted for approximately 64% of total sales; approximately 1% of total sales were in the form of DTA sales. The consumer channel accounted for approximately 35% of total sales.

5.11’s top 10 customers comprised approximately 21%, 26% and 27% of total sales in the years ended December 31, 2018, 2017 and 2016, respectively.

#### Sales and Marketing

5.11’s sales organization consists of a mix of direct employees, independent contractors and sales agencies. The domestic salesforce develops direct relationships with thousands of individual public safety departments around the U.S. and participates in thousands of requests for proposal (RFP) processes annually. The salesforce works directly with over 900 local dealers to service local public safety departments once a 5.11 product receives “spec” as part of the RFP process.



The international salesforce covers three primary regions: Asia Pacific, Europe, Middle East and Africa ("EMEA") and Latin America. While the company does fulfill some orders directly to international customers through its 5.11 website, most sales are serviced through third party distributors and dealers in foreign jurisdictions.

5.11 has implemented a multi-pronged marketing plan including investments in (i) professional and consumer product catalogues; (ii) print media; (iii) tradeshows; (iv) shop-in-shop retail concepts; and (v) digital and social media content.

5.11 had a backlog of \$17.3 million and \$26.4 million at December 31, 2018 and 2017, respectively.

#### Suppliers

5.11 operates an efficient, low-cost supply chain, sourcing most its products through contract manufacturers in the Asia Pacific region. Production from Vietnam accounted for approximately 35% of 5.11's purchases for the year ended December 31, 2017 and represented 5.11's largest sourcing region. No single core product is 100% sourced by any one vendor. Management believes that 5.11's principal manufacturers have the additional capacity to accommodate future growth.

Production of Beyond products occurs primarily through domestic subcontract facilities in the U.S. and through the brand's headquarters in Seattle, Washington.

To ensure vendor reliability and quality, 5.11 established a sourcing office in Hong Kong. The office employs approximately 50 individuals whose primary functions include vendor management, commercialization, product development, production planning, vendor compliance, quality assurance and compliance.

#### Intellectual Property

5.11 relies on brand name recognition and a combination of trademarks and patents in order to differentiate itself from the competition. 5.11 currently has 18 utility patents and 10 design patents issued, in addition to 17 utility and 3 design patents pending registration. 5.11 currently owns 319 registered trademarks including 3 trade dress registrations. The company has in-house general counsel that manages the registration and defense of 5.11 intellectual property.

#### Regulatory Environment

Management is not aware of any existing, pending, or contingent liabilities that could have a material adverse effect on 5.11's business. 5.11 is proactive regarding regulatory issues and is in compliance with all relevant regulations.

Management is not aware of any potential environmental issues.

#### Employees

As of December 31, 2018, 5.11 employed a total of 629 non-unionized, full-time employees, 47 independent contractors, and 132 temporary workers. None of 5.11's employees are subject to collective bargaining agreements. Management believes that 5.11 has an excellent relationship with its employees.

#### Ergobaby

##### Overview

Ergobaby is dedicated to building a global community of confident parents with smart, ergonomic solutions that enable and encourage bonding between parents and babies. Ergobaby offers a broad range of award-winning baby carriers, blankets and swaddlers, nursing pillows, and related products that fit into families' daily lives seamlessly, comfortably and safely. Ergobaby is headquartered in Los Angeles, California.

##### History of Ergobaby

Ergobaby was founded in 2003 by Karin Frost, who designed her first baby carrier following the birth of her son. The baby carrier product line has since expanded into 3-position and 4-position carriers, with multiple style variations. In its second year of operations, Ergobaby sold 10,500 baby carriers and today sells over 1 million a year. In order to support the rapid growth, in 2007, Ergobaby made a strategic decision to establish an operating subsidiary ("EBEU") in Hamburg, Germany. We purchased a majority interest in Ergobaby on September 16, 2010.

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 premium baby carriers and accessories and focuses its efforts on both the ergonomics and fashion of its products.

In 2013, Ergobaby expanded its portfolio into the sleep category. The launch of the Ergobaby Swaddler which focused on a unique method of swaddling newborns while retaining healthy hip and arm positioning, was the first significant category expansion outside of baby carriers for the Ergobaby brand. In 2016, Ergobaby expanded its offering in the sleep category with the launch of its Baby Sleeping Bag. Baby Tula is also in the sleep category with its blanket offering, focusing on limited edition fashion prints.

In 2014, Ergobaby launched the Ergobaby Four-Position 360 Baby Carrier which expanded on Ergobaby's leadership in the baby carrier category by offering an ergonomic, outward forward facing position for the baby and comfort for the parent. The Ergobaby 360 Carrier won the 2014 JPMA Innovation award in the baby carrier category. In 2016, Ergobaby launched the 3-Position Adapt Baby Carrier that is geared for newborns to toddlers (7lbs-45lbs) and offers some unique parent comfort features including lumbar support and crossable shoulder straps, as well as the benefit of being an all-in-one carrier with no need for an infant insert accessory (for babies 7-12lbs.). In 2017, Ergobaby launched the All Position, All-in-One Omni 360 Baby Carrier that is geared for newborns to toddlers (7lbs-45lbs) and includes all of Ergobaby's parent & baby comfort features from the 360 and Adapt Baby Carriers, as well as the same consumer benefit of no infant insert accessory needed.

In 2018, Ergobaby entered into the stroller category with 2 new models. The first product launched was a full-size option called the 180 Reversible Stroller. This was followed later in the year by a premium compact option, the Metro Compact City Stroller.

#### Industry

Ergobaby competes in the large and expanding infant and juvenile products industry. The industry exhibits little seasonality and is somewhat insulated from overall economic trends, as parents view spending on children as largely non-discretionary in nature. Consequently, parents spend consistently on their children, particularly on durable items, such as car seats, strollers, baby carriers, and related items that are viewed as necessities. Further, an emotional component is often a factor in parents' purchasing decisions, as parents' desire to purchase the best and safest products for their children. As a result, according to the USDA's most recent report on Expenditures on Children by Families 2013 (August 2014), parents on average, spend between \$9,130 and \$25,700 on their child on an annual basis for related housing, food, transportation, clothes, healthcare, daycare and other items, depending on age of the child and annual income. The amount spent by parents in the highest income group (before tax income greater than \$106,540) was more than twice the amounts spent by parents in the lowest income group (before tax income of less than \$61,530). On average, households spent between 14 - 25% of their before-tax income on a child. Similar patterns are seen in other countries around the world.

Demand drivers fueling the growing spending on infant and juvenile products include favorable demographic trends, such as (i) an increasing number of births worldwide; (ii) a high percentage of first time births; (iii) an increasing age of first time mothers and a large percentage of working mothers with increased disposable income; and (iv) an increasing percentage of single child households and two-family households.

In purchases of baby durables, parents often seek well-known and trusted brands that offer a sense of comfort regarding a product's reliability and safety. As a result, brand name, comfort and safety certifications can serve as a barrier to entry for competition in the market, as well as allow well-known brands such as Ergobaby and Baby Tula to compete in a growing premium segment.

#### Products and Services

##### Baby Carriers

Ergobaby has two main baby carrier product lines: baby carriers and related carrier accessories, sold under both the Ergobaby and Tula brands. Ergobaby's baby carrier designs supports a natural, ergonomic ("M" shaped) sitting position for babies, eliminating compression of the spine and hips that can be caused by unsupported suspension. The baby carrier also distributes the baby's weight evenly between parents' hips and shoulders, and alleviates physical stress for the parent. Both Ergobaby's 3-Position and 4-Position baby carriers have been recognized by the International Hip Dysplasia Institute as being "hip healthy". Additional accessories are provided to complement the baby carriers including the popular Infant Insert.

Within the Ergobaby Baby Carrier product line, Ergo sells 3-Position and 4-Position baby carriers in a variety of style and color variations and Baby Tula sells 3-Position, Standard, Toddler and Wrap Conversion fashion-oriented baby



carriers. Baby Carrier sales were approximately \$85.7 million, \$96.0 million and \$84.0 million in the years ended

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December 31, 2018, 2017, and 2016, respectively, and represented approximately 89%, 88% and 81%, of total sales in 2018, 2017, and 2016, respectively.

Within the baby carrier accessories category, the Infant Insert is the largest sales component of the accessory category. Accessory sales were \$6.7 million, \$8.6 million, and \$10.5 million, in 2018, 2017, and 2016, respectively, and represented approximately 7.0% in 2018, 8.4% in 2017 and 10% in 2016, of total sales.

Ergobaby's core Baby Carrier product offerings with average retail prices are summarized below:

Ergo

4 styles of baby carriers - \$115 - \$180

3 styles of Infant Inserts - \$25 - \$38

Tula

3 styles of baby carriers - \$149 - \$900

1 style of Infant Inserts - \$40

Competitive Strengths

Ergobaby innovation - Ergobaby Carriers are known for their unsurpassed comfort. Ergobaby's superior design results in improved comfort for both parent and baby. Parents are comfortable because baby's weight is evenly distributed between the hips and shoulders while baby sits ergonomically in a natural ("M" shaped) sitting position. The concept of baby carrying has increased in popularity in the U.S. as parents recognize the emotional and functional benefits of carrying their baby. Consumers continually cite the comfort, design, and convenient "hands free" mobility the Ergobaby carrier offers as key purchasing criteria. Ergobaby is also recognized as an industry leader in innovation. With the launch of the Ergo 4-Position 360 Carrier in 2014, the launch of the 3-Position ADAPT carrier in 2016, and the launch of the All Position Omni 360 carrier in 2017, Ergobaby continues to innovate in the baby carrier segment on a regular basis.

Baby Tula Community - Tula enjoys an active and enthusiastic community who are vocal advocates for the brand.

The Tula community acts as both an avid source of feedback on new product launches, which influence future product and patterns, as well as brand influencers to the broader new parenting community.

Business Strategies

Increase Penetration of Current U.S. Distribution Channels - Ergobaby continues to benefit from steady expansion of the market for wearable baby carriers and related accessories in the U.S. and internationally. Going forward, Ergobaby will continue to leverage and expand the awareness of its outstanding brands (both Ergobaby and Baby Tula) in order to capture additional market share in the U.S., as parents increasingly recognize the enhanced mobility, convenience, and the ability to remain close to the child that all Ergobaby carriers enable. Ergobaby currently markets its products to consumers in the U.S. through brick-and-mortar retailers, national chain stores; online retailers; and directly through Ergobaby.com and Babytula.com websites.

International Market Expansion - Testimony to the global strength of its lifestyle brand, Ergobaby has historically derived approximately 60% of its sales from international markets. Like it has in the U.S., Ergobaby can continue to leverage the Ergo and Tula brand equity in the international markets it currently serves to aggressively drive future growth, as well as expand its international presence into new regions. The market for Ergobaby's products abroad continues to grow rapidly, in part due to the growth in the number of births worldwide and the fact that in many parts of Europe and Asia, the concept of baby wearing is a culturally entrenched form of infant and child transport.

New Product Development - Management believes Ergobaby has an opportunity to leverage its unique, authentic lifestyle brands and expand its product line. Since its founding in 2003, Ergobaby has successfully introduced new carrier products to maintain innovation, uniqueness, and freshness within its baby carrier and travel system product lines and has become the baby carrier industry leader with the launch of the 4-Position 360 baby carrier. In addition to expanding into new product carriers like swaddling and nursing pillows, in 2018, Ergobaby entered the stroller category by introducing a new premium compact stroller (Metro Compact City Stroller) and a full-size stroller (180 Reversible Stroller).



### Customers and Distribution Channels

Ergobaby primarily sells its products through brick-and-mortar retailers, national chain stores, online retailers and distributors. In Europe, Ergobaby products are sold through its German based subsidiary, which services brick-and-mortar retailers and online retailers in Germany and France; its United Kingdom based subsidiary; and its Tula subsidiary in Poland; as well as a network of distributors located in Finland, Russia, Belgium, the Netherlands, Sweden, Norway, Spain, Denmark, Italy, Turkey and the Ukraine. Customers in Canada are predominately serviced by Ergobaby's Canadian subsidiary. Sales to customers outside of the U.S. and European markets are predominantly serviced through distributors granted rights, though not necessarily exclusive, to sell within a specific geographic region.

### Sales and Marketing

Within the U.S., Ergobaby directly employs sales professionals and utilizes independent sales representatives assigned to differing U.S. territories managed by in-house sales professionals. Independent salespeople in the U.S. are paid on a commission basis based on customer type and sales territory. In Europe, Ergobaby directly employs its salespeople and salespeople are paid a base salary and a commission on their sales, which is standard in that territory.

Ergobaby has implemented a multi-faceted marketing plan which includes (i) online marketing efforts, including online advertisement, search engine optimization and social networking efforts; (ii) increasing tradeshow attendance at consumer and medical professional shows; and (iii) increasing promotional activities.

Ergobaby had approximately \$11.9 million and \$9.2 million in firm backlog orders at December 31, 2018 and 2017, respectively.

### Competition

The infant and juvenile products market is fragmented, with a few larger manufacturers and marketers with portfolios of brands and a multitude of smaller, private companies with relatively targeted product offerings.

Within the infant and juvenile products market, Ergobaby's baby carriers primarily compete with companies that market wearable baby carriers. Within the wearable baby carrier market, several distinct segments exist, including (i) slings and wraps; (ii) soft-structured baby carriers; and (iii) hard frame baby carriers.

The primary global competitors in this segment are BabyBjorn, Chicco, Britax and Manduca, which also market products in the premium price range. Especially in the U.S., Ergobaby brands also compete with several smaller companies that have developed wearable carriers, such as Infantino, Boba, and Lillebaby. Within the soft-structured baby carrier segment, Ergobaby benefits from strong distribution, good word of mouth, and the functionality of the design.

### Suppliers

During 2018, Ergobaby sourced its Ergo carrier and carrier accessory products from Vietnam and India, and manufactured its stroller systems and accessory products in China. Baby Tula products predominantly were produced from factories in India and Poland and were also produced in its own facility located in Poland. In 2012, Ergobaby began sourcing carriers and accessories from a manufacturing facility in Vietnam and in 2009, Ergobaby partnered with a manufacturer located in India. More than 50% of Ergobaby's carriers and accessories came from Vietnam in 2018. Baby Tula sourced its carrier, accessories and blanket products from Poland, Vietnam and India, with purchases from these locations accounted for approximately 11% of total Ergobaby purchases. Management believes its manufacturing partners have the additional capacity to accommodate Ergobaby's projected growth.

### Intellectual Property

Ergobaby maintains and defends a U.S. and international patent portfolio on some of its various products, including its 3-position and 4-position carriers. Currently, it has 24 patents (including allowances) and 17 patents pending in the U.S. and other countries. Ergobaby also depends on brand name recognition and premium product offering to differentiate itself from competition.

### Regulatory Environment

Management is not aware of any existing, pending, or contingent liabilities that could have a material adverse effect on Ergobaby's business. Ergobaby is proactive regarding regulatory issues and is in compliance with all relevant regulations. Ergobaby maintains adequate product liability insurance coverage and to date has not incurred any losses. Management is not aware of any potential environmental issues.



## Employees

As of December 31, 2018, Ergobaby employed 171 persons in 6 locations. None of Ergobaby's employees are subject to collective bargaining agreements. We believe that Ergobaby's relationship with its employees is good.

## Liberty Safe

### Overview

Liberty Safe, headquartered in Payson, Utah and founded in 1988, is the premier designer, manufacturer, and marketer of home, gun and office safes in North America. From its over 300,000 square foot manufacturing facility, Liberty Safe produces a wide range of home, office 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 Safe 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" or "National sales"). Liberty Safe has the largest independent dealer network in the industry, with more than 50% of Liberty's sales in the last two years coming from the dealer network.

### History of Liberty Safe

The Liberty Safe brand and its leading market share has been built over a 30-year history of superior product quality, engineering and design innovation, and leading customer service and sales support. Liberty Safe has a long history of continuous improvement and innovative approaches to sales and marketing, product development and manufacturing processes. Significant investments over the last five years have solidified Liberty Safe's reputation for providing substantial value to retailers and enhanced its long-standing position as the leading producer of premium home, office and gun safes.

Liberty Safe commenced operations in 1988 and in 2001 opened its current state-of-the-art facility in Payson, Utah. The new facility allowed Liberty Safe to consolidate all of its manufacturing and distribution operations to a centralized location. As the only facility in the industry utilizing significant automation and a streamlined roll-form manufacturing process, it represented a significant step forward when compared to the production capabilities of its competitors. Incremental investments following the consolidation have solidified Liberty Safe's position as the preeminent low-cost and most efficient domestic manufacturer.

During 2011, Liberty Safe constructed a new production line that allowed Liberty to build entry level safe products in-house. This production line produces home and gun safe models that were previously completely sourced through foreign manufacturers. This investment in production capacity makes Liberty Safe one of the largest manufacturer of home, office and gun safes in the world. This added investment in capacity in the U.S. allowed Liberty Safe to provide shorter lead times and more competitive pricing to its North American customer base.

We purchased a majority interest in Liberty Safe on March 31, 2010.

### Industry

Liberty Safe competes in the broadly defined North American safe and vault industry which includes fire and document safes, media and data safes, depository safes, gun safes and cabinets, home safes and hotel safes. According to Technavio's 2016 global safes and vaults market report, the global safe market was estimated to be approximately \$2.9 billion in 2015, and is projected to grow at a CAGR of 5.5% through 2020. Gun safes and vaults comprise approximately 16.5% of the global safe market and it is expected that percentage will remain consistent through 2020. Domestically, demand for safes depends on several key factors, including per capita disposable income since safes are largely considered a discretionary purchase in most households. The gun safe segment of the industry typically sees demand that closely correlates to the demand from guns and ammunition manufacturers. When gun sales increase, the potential market for gun safes typically also increases. Increased fears surrounding violence in the country along with political uncertainty concerning gun ownership laws play a part in changes in gun ownership and subsequently, demand for gun safes. The profitability of individual companies depends on efficient operations and effective marketing, with large companies able to take advantage of economies of scale in production and distribution, while smaller companies compete through specialty products.

The domestic safe industry continues to see increased competition from imports, particularly those sourced from China. Imported safes were expected to comprise approximately one-third of the domestic sales in 2018, with competition



from imports highest in the small safe product group, which are targeted at households. Imported safes compete on price, with foreign manufacturers passing along savings from operational efficiencies, lower cost labor and raw materials to the end consumer. The competition from imported safes may make it harder to pass increasing costs, including the cost of steel, to the end consumer.

#### Products and Services

Liberty Safe offers home, office and gun safes with retail prices ranging from \$400 to \$8,000. Liberty Safe produces 32 home and gun safe models with the most varied assortment of sizes, feature upgrades, accessories and styling options in the industry. Liberty Safe's premium home and gun safe product line covers sizes from 12 cu. ft. to 50 cu. ft. with smaller sizes available for its personal home safe. Liberty Safe markets its products under Company-owned brands and a portfolio of licensed and private label brands, including Cabela's, Case IH, Colt and John Deere. Liberty Safe also sells commercial safes, vault doors, handgun vaults, and a number of accessories and options. The overwhelming majority of revenue is derived from the sales of safes.

#### Competitive Strengths

**#1 Premium Home and Gun Safe Brand with Strong Momentum in the Market** - Liberty Safe achieved the status of #1 selling safe company in America in 1994 (per statistics provided by Sargent & Greenleaf, the primary lock supplier to the industry) and maintains this prominent position today. Liberty Safe continues to gain market share from the various smaller participants who lack the distribution and sales and marketing capabilities of Liberty Safe.

**State-of-the-Art and Scalable Operations** - Liberty's management has constructed a highly scalable operational platform and infrastructure that has positioned Liberty Safe for substantial sales growth and enhanced profitability in the coming years. Liberty Safe transitioned itself from a manufacturing oriented operating culture to a demand-based, sales-oriented organization. Its strategic transition required the implementation of a demand-based sales and operating platform, which included (i) new equipment to drive automation and capacity improvements; (ii) re-engineered product lines and production processes to drive efficiency through greater standardization in production; and (iii) new employee incentives tied to labor efficiency, which has improved worker performance as well as employee attitude.

These initiatives are enhanced by an experienced senior executive team, a balanced sourcing and in-house manufacturing production strategy, advanced distribution capabilities and sophisticated IT systems. Liberty has combined its demand-based sales and operating initiatives with upgraded production equipment to drive multiple operational improvements. These initiatives combined with Liberty's cumulative historical investments in operational capabilities have created a lasting competitive advantage over its smaller competitors, who utilize labor-intensive operations and lack the company's lean manufacturing culture. For the past seventeen years, Liberty Safe has leased a manufacturing and distribution facility in Payson, Utah that management believes represents the most scalable domestic facility in the industry. Liberty Safe's multi-faceted production capabilities allow for substantial flexibility and scalable capacity, thus assuring a level of supply chain execution far superior to any of its competitors.

Historically, Liberty Safe maintained an optimal mix of in-house and Asian-sourced manufacturing in order to improve its ability to meet customer inventory needs. Beginning in 2012, Liberty Safe began manufacturing entry level safes that were previously completely sourced from an Asian manufacturer, on its new production line. In 2018, only 4% of safes (excluding handgun safes) sold by Liberty were sourced in Asia.

**Reputation for High Quality Products** - Liberty Safe offers only the highest quality products on a consistent basis, which over the years has gained it an enviable reputation and a key point of differentiation from its competitors. Liberty Safe distinguishes its products through tested security and fire protection features and industry leading design focused on functionality and aesthetics. The design of its safes meet rigorous internal benchmarks for security and fire protection, with most receiving certification from Underwriters Laboratory, Inc. ("UL"), the leading product safety standard certification, for its security capabilities. Additionally, Liberty Safe's investment in accessories and feature options have made Liberty safes the most visually appealing and functional in the industry, while providing more customized solutions for retailers and consumers.

**Trusted Supplier to National Retailer and Dealer Accounts** - Liberty Safe's comprehensive, high-quality product offering and sophisticated sales and marketing programs have made it a critical supplier to a diverse group of national accounts and dealers. Initially a key supplier primarily to the dealer channel, it has expanded its business with national accounts, such as Cabela's and John Deere. Liberty Safe provides a superior value proposition as a supplier for its national retailers and dealers via its well-recognized brands, lifetime product warranty, tailored merchandising,



category management solutions and superior supply chain execution. Further, Liberty Safe's products generate more profitable floor-space, with both high absolute gross profit and retail margins over 30%. High retail profitability plus increased inventory turns has entrenched Liberty Safe as a key partner in customers' success in the safe category. As a core

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element of building its relationships, Liberty Safe has invested significantly in making its retailers better salespeople through a proprietary suite of training tools, including in-store training, new product demonstrations, online education programs and sales strategy literature.

#### Business Strategies

Liberty Safe has experienced strong historical growth while executing on multiple new sales and operational initiatives, positioning it to continue to increase its scale and improve profitability. Liberty's growth strategy is rooted in the sales and marketing and operational initiatives that have spurred its expansion into new accounts and increased penetration of existing accounts. Liberty has significant opportunity in its existing channels to continue to build upon its already strong market share. In addition to growth within its current channels, Liberty's core competencies can be successfully applied to ventures in the broader security equipment market. Liberty has explored certain of these opportunities, but due to the prioritization of operational initiatives and expansion opportunities within existing channels, they have not been aggressively pursued. Potential near-to-medium term areas for expansion of Liberty's platform include:

- Expand Liberty's product line into the broader home and office safe market through current customers or new distribution strategies;
- Further develop international distribution by entering new countries and expanding current limited presence in Canada, Mexico and Europe;
- Enter the residential security market through a strategic partnership with a provider of residential security service solutions to provide a more complete physical and electronic security solution;
- Acquire businesses within the premium home and gun safe industry and/or leverage Liberty's platform into new products or channels; and
- Offer additional accessory products to existing distribution networks.

#### Research and Development

Liberty Safe is the engineering and design leader in its sector, due to a history of first-to-market features and standard-setting design improvements. Liberty's proactive solicitation of feedback and constant interaction with consumers and retail customers across diverse channels and geographies enables Liberty Safe to stay at the forefront of customer demands. Liberty's approach to product development increases the likelihood of market acceptance by creating products that are more relevant to consumers' demands. Research and development costs were \$0.2 million in 2018, \$0.5 million in 2017, and \$0.3 million in 2016.

In addition to product enhancements, new products, such as the plate-door National Security Classic, and a new, 6-SKU line of handgun vaults were launched in 2015 from Liberty's commitment to R&D. In 2016, Liberty introduced a new 3-section "Extreme" interior design, new safe covers, new handgun vault designs, and several new safe sizes. In 2018, Liberty introduced a new flat pin design (patent pending) in all of its large safes. This new design provides a much higher level of security against pry-attacks.

#### Customers and Distribution Channels

Liberty Safe has fostered long-term relationships with leading national retailers (National or Non-Dealer) as well as numerous Dealers, enabling Liberty Safe to achieve considerable brand awareness and channel exposure. Through significant investment in its national accounts sales and marketing efforts, Liberty Safe has also become a leading supplier to National accounts. Expansion into National accounts is part of Liberty Safe's strategy to reach a broader customer base and more varied demographics. National account customers include sporting goods retailers, farm and fleet retailers, and home improvement retailers. As of December 31, 2018, 2017 and 2016, Liberty Safe had 20, 16 and 13 Non-Dealer account customers, respectively, that are estimated to have accounted for approximately 40%, 46% and 50% of net sales, respectively.

Dealer customers include local hunting and fishing stores, hardware stores and numerous other local, independent store models. As of December 31, 2018, 2017 and 2016, there were 405, 406 and 392 Dealers that accounted for 60%, 54% and 50% of net sales, respectively.

Liberty Safe's two largest customers accounted for approximately 29.5%, 32.6% and 36.5% of net sales in 2018, 2017 and 2016, respectively.

#### Seasonality

Liberty Safe typically experiences its lowest earnings in the second quarter due to lower demand for safes at the onset of summer.

### Sales and Marketing

Liberty Safe possesses robust sales and marketing capabilities in the safe industry. Liberty Safe utilizes separate sales teams for National accounts and Dealers, which enables it to provide more focused and effective strategies to manage and develop relationships within different channels. Liberty Safe has made significant recent investments in the development of a comprehensive sales and marketing program including merchandising, sales training and tools, promotions and supply chain management. Through these various initiatives, Liberty Safe offers highly adaptable programs to suit the varying needs of its retailers. This has enabled Liberty Safe to become a key supplier across diverse channels. Liberty Safe began advertising nationally on the Glenn Beck radio show in the second half of 2010. This advertising has been highly successful and Liberty has continued this advertising in each of the following years and intends on continuing this advertisement in the future.

Liberty Safe's comprehensive service offering makes it uniquely suited to service national retailers in a variety of channels. Liberty Safe has designed a Store-within-a-Store program and a more comprehensive Safe Category Management program to build relationships and increase its importance to retailers. Primarily utilized with sporting goods retailers, the Store-within-a-Store concept successfully integrates the effective sales strategies of its dealers for selling a high-price point, niche product into a larger store format. Centered on communicating the benefits of its products to customers, the program enables retailers to more effectively up-sell customers through a good-better-best merchandising platform, increasing margin and inventory turns for its retailers. Liberty's Safe Category Management program builds on the Store-within-a-Store concept to provide greater sales and marketing control and more complete inventory management solutions. This program facilitates Liberty Safe becoming the sole supplier to retailers, providing large incremental expansion and stronger relationships at accounts. No other market participant has the capabilities to provide a comprehensive suite of customer service solutions to national retailers, such as customized SKU programs, a Store-within-a-Store program and a Safe Category Management program.

### Competition

Liberty Safe is the premier brand in the premium home and gun safe industry, with an estimated 34% market share in the category. Liberty is in a class by itself when it comes to manufacturing technology and efficiency and supply chain capabilities. Competitors are generally more heavily focused on either smaller, sourced safes or large, domestically produced safes. Competitive domestic manufacturers run "blacksmith" type factories that are small, inefficient and require a tremendous amount of manual labor that produces inconsistent product. In addition, many of Liberty's competitors are directly tied to a third-party brand, such as Browning or Winchester.

Liberty competes with other safe manufacturers based on price, breadth of product line, technology, product supply chain capabilities and marketing capabilities.

Channel diversity in the premium home and gun safe industry is rare, with most companies having greater concentration in either the dealer channel or national accounts, but rarely having the supply chain capabilities or sales and marketing programs to service both channels effectively such as Liberty Safe does. Major competitors have limited sales and marketing departments and programs, making it difficult for them to expand sales and gain market share.

### Suppliers

Liberty's primary raw materials are steel, sheetrock, wood, locks, handles and fabric, for which it receives multiple shipments per week. Materials, on average, account for approximately 60% of the total cost of a safe, with steel accounting for approximately 45% of material costs. Liberty purchases its materials from a combination of domestic and foreign suppliers. Historically, Liberty Safe has been able to pass on raw material price increases to its customers. Liberty purchased approximately 18 million pounds of steel in 2018 primarily from domestic suppliers, using contracts that lock in prices two fiscal quarters in advance. Liberty Safe purchases coiled and flat steel in gauges from four to fourteen. Liberty Safe specifies rigorous requirements related to surface and edge finish and grain direction. All steel products are checked to ASTM specification and dimensional tolerances before entering the production process.

Liberty Safe had approximately \$6.0 million and \$6.2 million in firm backlog orders at December 31, 2018 and 2017, respectively.

### Intellectual Property

Liberty Safe relies upon a combination of patents and trademarks in order to secure and protect its intellectual property rights. Liberty Safe currently owns 32 trademarks and 4 patents on proprietary technologies for safe products.

## Regulatory Environment

Liberty Safe's management believes that Liberty Safe is in compliance with applicable environmental and occupational health and safety laws and regulations. Liberty Safe has recently moved to a powder paint application in order to reduce hazardous VOC emissions.

## Employees

As of December 31, 2018, Liberty Safe had 344 full-time employees and 6 temporary employees. Liberty's labor force is non-union. Management believes that Liberty Safe has an excellent relationship with its employees.

## 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 among the fastest growing in the natural foods industry, are currently carried in approximately 16,500 retail stores across the United States and Canada. Manitoba Harvest's hemp-based, all-natural product lineup includes hemp hearts, protein powder, hemp oil, hemp milk substitute, and snacks. As the world's largest vertically-integrated hemp food manufacturer, Manitoba Harvest is involved in every aspect of the hemp production process, from "seed-to-shelf." All of Manitoba Harvest's products are an excellent source of plant-based protein and essential fatty acids, including omega-3, gamma-linolenic acid and stearidonic acid. The hemp-based food market is rapidly growing as consumers become aware of the unique combination of great taste and nutritional benefits of hemp-based foods.

We purchased a majority interest in Manitoba Harvest on July 10, 2015, and we sold Manitoba Harvest subsequent to year-end in the first quarter of 2019.

### History of Manitoba Harvest

Founded in 1998 following the legalization of industrial hemp production in Canada, Manitoba Harvest has been the industry leader in the manufacture of the highest quality hemp food products while educating people on the benefits of hemp nutrition. Manitoba Harvest initially sold the company's raw hemp seed and oil products in natural food stores with distribution and marketing efforts focused on promotion of consumer acceptance of hemp seeds as a food product. In 2001, Manitoba Harvest began selling their products at Whole Foods and Loblaws, one of Canada's largest supermarket chains, which allowed for expansion beyond natural food stores. As hemp food products continued to gain mainstream acceptance, Manitoba Harvest launched additional hemp-based products, including a hemp protein powder line, a hemp smoothie line and hemp-based snacks. Manitoba Harvest's facility in Winnipeg achieved organic certification in 2004 and non-GMO verification in 2009. Manitoba Harvest has the highest level of global certification in food safety and quality and is the first and only hemp-based food company to achieve British Retail Consortium Global Food Safety Initiative ("BRC") AA+ certification. Leveraging its proven innovation capabilities and position as an industry leader, Manitoba Harvest is currently introducing new product formats with broad appeal, and expanding its presence in retail channels, particularly grocery channels and e-commerce, to capitalize on strong demand from existing customers and to broaden its appeal to reach mainstream consumers.

On December 15, 2015, Manitoba Harvest acquired all the outstanding stock of Hemp Oil Canada Inc. ("HOCI"). HOCI is a wholesale supplier and a private label packager of hemp food products and ingredients. With the acquisition of HOCI, Manitoba Harvest has added a leading manufacturer and supplier of hemp food products and ingredients for a global customer base.

### Industry

Hemp is the distinct oilseed and fiber varieties of the plant species *Cannabis sativa* L., a tall fibrous plant that has been cultivated worldwide for more than 10,000 years. The hemp crop was introduced to North America in the early 1600s, and it played an integral part in North America's early history as it was used as a material for various products including riggings and sails on naval ships, paper and fuel oil. Hemp is versatile, with diverse uses from food products to clothing, building materials, fuel and various other applications. As a food product, hemp is packed with essential nutrients such as protein, healthy fats, fiber, magnesium and all 10 essential amino acids.

As a crop, hemp is a low impact and environmentally sustainable resource that can be grown without pesticides or agricultural chemicals. Hemp is beneficial to the agricultural supply chain, aiding in weed suppression and soil

building, making it a favored rotation crop. Hemp comes from the *Cannabis sativa* L. subspecies *sativa*, which is a different

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subspecies from that grown to produce marijuana, subspecies indica. Hemp contains 0.001% Tetrahydrocannabinol (“THC”). Although it is completely legal to further process and consume hemp-based food products in the U.S., until recently there have been legal restrictions against cultivation of hemp or the processing of live seeds. As a result, U.S. marketers of hemp-based products were required to import essentially all of the hemp seed, oil and fiber that they need. However, the regulatory environment in the U.S. is slowly changing. The U.S. Agriculture Act of 2014 defined industrial hemp as distinct from marijuana and authorized institutions of higher learning and state agriculture departments to grow industrial hemp for research and agricultural pilot programs, leading to certain states that have legalized hemp cultivation and have begun to authorize farmers to plant and grow hemp for experimental purposes. Further, the U.S. Farm Bill passed December 2018 fully legalized the cultivation and sale of industrial hemp at the federal level, effective January 1, 2019.

In Canada, the commercial cultivation of hemp was authorized in 1998 with the implementation of the Canadian Industrial Hemp Regulations, which governs the cultivation, processing, transportation, sale, import and export of industrial hemp. Since its legalization, hemp has garnered significant interest among Canadian farmers and the Canadian government has supported the industry through market development funding and a favorable regulatory environment. The Canadian agricultural industry views hemp as a valuable alternative crop that complements prairie crop production rotations and offers significant economic opportunity due to its numerous end uses.

Hemp-based foods are considered a superfood that are rich in healthy fats and other important minerals; furthermore, hemp seeds are an excellent dietary source of easily digestible plant-based protein. The unique nutritional profile of hemp foods appeals to a broad base of modern diet trends, ranging from paleo to vegetarian diets. Manitoba Harvest broadly competes in the Nuts & Seeds and Protein Powder categories, which Nielsen estimates to be \$4.4 billion and \$540 million at retail, respectively. The QYR Food and Beverages Research Center estimated hemp-based food and personal care revenue for the United States and Canada at just under USD \$372 million in 2017.

#### Products

Manitoba Harvest is a global leader in branded, hemp-based foods. The company’s products are the fastest growing products in the hemp food market and among the fastest growing in the entire natural foods industry. The company’s hemp-exclusive, consumer-facing 100% all-natural product lineup includes Hemp Hearts, protein powder, and snacks. Manitoba Harvest processes natural and organic hemp seed which are sold as hulled seed, hemp oil, hemp protein, toasted hemp seed and coarse hemp powder.

Hemp Hearts - Hemp Hearts are raw shelled hemp seeds and have a slightly nutty taste, similar to that of a sunflower seed or a pine nut. Hemp Hearts contain 10 grams of plant-based protein and 12 grams of omega essential fatty acids per 30 gram serving. Hemp Hearts can be used as a topping for yogurt, salads, cereal, as a component for smoothies and other meals, or eaten directly from the package. Manitoba Harvest offers Hemp Hearts in all-natural and organic varieties through a number of SKUs. Hemp Hearts are all-natural and non-GMO verified. Hemp Hearts represented approximately 72% of Manitoba Harvest’s gross revenues in 2018.

Hemp Protein Powder - Manitoba Harvest offers a variety of plant-based proteins that serve a multitude of culinary and dietary needs including HempYeah! Plant Protein Blends in three flavors, HempYeah! Max Protein, Hemp Yeah! Balanced Protein + Fiber, and HempYeah! Max Fiber in three flavors. Manitoba Harvest protein powders are plant-based products that are great complements to fruit smoothies, added to yogurt, hot cereal, or incorporated into baking products. Manitoba Harvest offers hemp protein products in all-natural and organic varieties, and all protein powders are non-GMO verified. Hemp protein powders represent approximately 15% of Manitoba Harvest’s gross revenues in 2018.

Hemp Oil, Hemp Bliss and Other Products - Manitoba Harvest’s other products include Hemp Oil, in both liquid and soft-gel formats, and Hemp Bliss, a non-dairy beverage. Hemp oil is a cold-pressed oil with no preservatives or artificial colors and is commonly used as a low heat culinary oil or as an ingredient in dressings or sauces. Hemp snacks, Hemp oil and Hemp Bliss comprised approximately 13% of Manitoba Harvest's gross revenues in 2018.





### Competitive Strengths

**Leading Brand Recognition & Market Share** - Manitoba Harvest is an award-winning pioneer and global leader in branded, hemp-based foods. Consumer awareness of hemp-based foods and the Manitoba Harvest brand continues to grow rapidly. Manitoba Harvest has developed considerable brand equity with a growing, highly-loyal, and very passionate consumer following. Management believes that Manitoba Harvest holds more than 50% of the market share of hemp heart seed sales and hemp protein powder sales in North America.

**Strong Core Consumer Base** - Manitoba Harvest's core consumers are those who generally prefer all-natural products and focus on practicing a lifestyle of health and sustainability. Among its core consumer base, hemp-based foods have a high level of awareness and Manitoba Harvest possesses a high level of brand recognition among this consumer segment. Consumers tend to be extremely loyal after incorporating Manitoba Harvest's hemp foods into their lifestyle. Consumers develop a bond with the Manitoba Harvest brand and appreciate that Manitoba Harvest seeks to positively impact the community and the environment with its actions. Manitoba Harvest is committed to having a material positive impact on society and the environment. The company takes this commitment very seriously, and communicates this to consumers, in part, by maintaining certification as a registered "B-Corporation". Through its actions, Manitoba Harvest inspires consumers to "live the brand" and lead happier and healthier lives.

**Vertically-Integrated Supply Chain with Long-Term Relationships with Suppliers** - Manitoba Harvest enjoys strong relationships with hemp producers, some dating back to their inception in 1998. Manitoba Harvest has a rigorous qualification process for its suppliers which includes an ongoing supplier scorecard and chooses to purchase hemp seeds from only the highest quality growers. With limited exception, farmers working with Manitoba Harvest are exclusive to them. In North America, hemp is only grown commercially in Canada and Manitoba Harvest accounts for more than 60% of the hemp supply, minimizing risk and ensuring quality hemp seeds for their product. The majority of Canada's hemp supply outside of Manitoba Harvest's business goes into ingredient and wholesale markets, making Manitoba Harvest the only vertically-integrated, branded hemp-based food company in North America.

### Business Strategies

Manitoba Harvest's management believes it is well positioned for continued topline growth. As consumer awareness of and demand for hemp-based foods increases, Manitoba Harvest will continue to leverage its market leadership and strong brand awareness to grow through existing customers, broadened distribution, new product launches, and expanded ingredients business.

**Increasing consumer awareness** - Manitoba Harvest was founded with the mission to educate consumers on the health and environmental benefits of hemp-based food products and is working to drive awareness with consumers on multiple fronts. Manitoba Harvest is driving consumer awareness through media outreach, a growing social media community, digital media and network of brand ambassadors. Manitoba Harvest is increasing its investment in digital media, coupons, in-store displays, and product demos at key retailers in the United States and Canada. Educating shoppers in the U.S., many of whom are unaware of the benefits of hemp foods, will continue to drive sales among shoppers and build relationships at accounts. Manitoba Harvest is also a co-sponsor of Hemp History Week, an annual event that features hundreds of product demos and promotional events at major retailers throughout the U.S., including Whole Foods Market.

**Continued growth with existing customers** - Manitoba Harvest expects to grow same store sales with existing customers by expanding the presence of their products on the shelf throughout stores through the introduction of new formats, improved retail product placement and increased investment in merchandising.

**Expansion into new customers** - Management believes it has significant opportunity to enter new grocery customers in the mainstream grocery channel, both in Canada and the United States. The grocery channels in both the United States and Canada have experienced significant sales growth in all-natural and organic product categories while sales in traditional product categories have been flat or decreased. Manitoba Harvest continues to invest in its sales capabilities to improve access and engagement with key retail accounts in order to capitalize on consumer demand for healthy eating.

Continued innovation and new product development - In 2018, the company introduced a new line of plant protein blends under the newly created HempYeah! Brand. In addition, all hemp protein powders were renovated under the HempYeah! Brand with clearer consumer positing and updated packaging. Management plans to continue to innovate on existing product lines through new formats and flavors as well as continued development of new product categories to broaden customer appeal and increase the number of hemp food usage occasions.

Expanded ingredient business - With the acquisition of HOCI in 2015, Manitoba Harvest added a leading manufacturer and supplier of hemp food products and ingredients. As hemp-based food usage continues to become more widely adopted, management believes the strategic acquisition of HOCI has positioned the company to capitalize on the growing opportunity to be the ingredient supplier of choice to other leading food manufacturers in complementary food product categories.

#### Research and Development

Manitoba Harvest competes in the natural products industry, which is characterized by research and development and which yields food product innovations that contribute to human wellness and sustainable development. The scope of research and development is focused on new product development, product enhancement, process design and improvement, packaging, and meeting the needs of the expanding international business. Additionally, management utilizes analytics to manage the evolution of its relationships with its customers, and conducts consumer research during early stages of new product development initiatives in order to identify key success factors. Manitoba Harvest spent approximately \$0.6 million, \$0.7 million and \$0.3 million, respectively, on research and development in 2018, 2017, and 2016. In 2018, hemp seeds, oils and protein powders received GRAS (Generally Regarded As Safe) status from the FDA.

#### Customers and Distributions Channels

Manitoba Harvest sells its products through four primary retail channels: natural foods, club, conventional grocery, and e-commerce. After initially establishing the authenticity of its brand and products in the natural channel at retailers such as Whole Foods Markets and Sprouts, Manitoba Harvest expanded into the club and grocery channel, initially in Canada, and then in the United States and internationally. In addition, the company sells their hemp food products and ingredients to value-added manufacturers to be used in hemp cereals, hemp milk, nutrition and protein bars and powders, baked goods, and salad dressings.

Manitoba Harvest's three largest customers accounted for approximately 40% of total sales in 2018, 36% of total sales in 2017, and approximately 47% of total sales during 2016. In 2018, approximately 69% of Manitoba Harvest's gross sales were to customers in the United States and approximately 28% were to customers in Canada. The remaining 3% were primarily to customers in a broad range of international locations. In 2017, approximately 57% of Manitoba Harvest's gross sales were to customers in the United States and approximately 38% of gross sales were to customers within Canada. The remaining 5% were primarily to customers in a broad range of international locations.

#### Sales and Marketing

Manitoba Harvest grows sales within existing retail partners by educating and engaging potential consumers through in-store demos, consumer events and sampling.

In addition to partnering with national natural food channel brokers, Manitoba Harvest's sales organization consists of sales professionals with direct sales coverage of over 1,000 retail locations. The sales force is led by the Senior Vice President of Sales and consists of sales managers, territory managers and brand ambassadors dedicated to specific regions in Canada and the United States. Manitoba Harvest's sales force is focused on the natural, club and grocery channels, through direct key account coverage and winning sales through a focus on data for category and customer management. In addition to direct sales, the company uses a network of distributors to service many of its customers. Manitoba Harvest focuses the majority of sales spending in three key areas: demonstrations/sampling, fixed trade spending and promotions. Successful product demonstrations within the club and grocery channels have helped drive increased sales productivity. Manitoba Harvest utilizes fixed trade spending to secure end-cap positions, ad space and off-shelf displays at various retailers. Additionally, they strategically utilize promotions to position its products in prime display space at retailers.

#### Competition

The emerging hemp foods category has a limited number of participants that offer a minimal number of hemp-based products while focusing on a broader assortment of food items. While increasing, competition remains limited due to restricted raw hemp seed access in the United States. Manitoba Harvest's strong supplier relationships, regulated access to hemp seeds and deep knowledge of the growing and harvesting of hemp afford the company with a unique competitive advantage.



Manitoba Harvest has the highest level of global certification in food safety and quality and is the first and only hemp-based food company to achieve British Retail Consortium (“BRC”) AA+ Global Food Safety Initiative certification.

#### Suppliers

Manitoba Harvest is strategically located near their supply of hemp in Canada. The commercial cultivation of hemp was authorized in Canada in 1998 with the implementation of the Canadian Industrial Hemp Regulations. This governs the cultivation, processing, transportation, sale, import and export of industrial hemp. Industrial hemp is viewed by the Canadian and agricultural industry as a valuable new alternative crop that complements crop production rotations and offers significant economic opportunity through numerous end uses. The prairie provinces of Manitoba, Saskatchewan and Alberta have emerged as a leading region for growing hemp due to the ideal agricultural characteristics: a long growing season, sufficient moisture levels, and supportive local governments that view hemp as a strategic crop. The adaptability o