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COMPX INTERNATIONAL INC
Form 10-Q
May 04, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended March 31, 2006

Commission file number 1-13905

COMPX INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Delaware

57-0981653

(State or other jurisdiction of
organization) Identification No.)

(IRS Employer

5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240-2697

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (972) 448-1400

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Large accelerated filer Accelerated filer Non-accelerated filer X.

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No X .

Number of shares of common stock outstanding on April 26, 2006:

Class A: 5,234,280

Class B: 10,000,000

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COMPX INTERNATIONAL INC.

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COMPX INTERNATIONAL INC.

CONSOLIDATED BALANCE SHEETS

(In thousands)

| ASSETS | December 31, 2005 |
|------------------------------------|----------------------|
| | ----- (Unaudited) |
| Current assets: | |
| Cash and cash equivalents | \$ 30,592 |
| Accounts receivable, net | 20,609 |
| Receivables from affiliates | 620 |
| Refundable income taxes | 401 |
| Inventories | 22,538 |
| Prepaid expenses and other | 1,496 |
| Deferred income taxes | 1,903 |
| Current portion of note receivable | 2,612 |
| | ----- |
| Total current assets | 80,771 |
| | ----- |
| Other assets: | |
| Goodwill | 35,678 |
| Other intangible assets | 2,317 |
| Note receivable | 1,567 |
| Other | 230 |
| | ----- |
| Total other assets | 39,792 |
| | ----- |
| Property and equipment: | |
| Land | 7,868 |
| Buildings | 31,165 |
| Equipment | 107,333 |
| Construction in progress | 2,015 |
| | ----- |
| | 148,381 |
| | ----- |
| Less accumulated depreciation | 80,392 |
| | ----- |
| Net property and equipment | 67,989 |
| | ----- |
| | \$188,552 |
| | ===== |

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COMPX INTERNATIONAL INC.
 CONSOLIDATED BALANCE SHEETS (CONTINUED)
 (In thousands)

| LIABILITIES AND STOCKHOLDERS' EQUITY | December 31, 2005 ----- |
|--|-------------------------------|
| Current liabilities: | |
| Accounts payable and accrued liabilities | \$ 19,238 |
| Income taxes payable to affiliates | 771 |
| Income taxes | 327 |
| | ----- |
| Total current liabilities | 20,336 |
| | ----- |
| Noncurrent liabilities: | |
| Long-term debt and other | 1,425 |
| Deferred income taxes | 16,692 |
| | ----- |
| Total noncurrent liabilities | 18,117 |
| | ----- |
| Stockholders' equity: | |
| Preferred stock | - |
| Class A common stock | 52 |
| Class B common stock | 100 |
| Additional paid-in capital | 109,556 |
| Retained earnings | 31,320 |
| Accumulated other comprehensive income | |
| - currency translation | 9,071 |
| | ----- |
| Total stockholders' equity | 150,099 |
| | ----- |
| | \$188,552 |
| | ===== |

Commitments and contingencies (Note 1)

See accompanying notes to consolidated financial statements.

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COMPX INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF INCOME

Three months ended March 31, 2005 and 2006

(In thousands, except per share data)

(Unaudited)

| | 2005 |
|--|----------|
| | ----- |
| Net sales | \$46,843 |
| Cost of goods sold | 36,560 |
| | ----- |
| Gross margin | 10,283 |
| Selling, general and administrative expense | 6,122 |
| Other operating income (expense): | |
| Currency transaction losses, net | (54) |
| Disposition of property and equipment | 5 |
| | ----- |
| Operating income | 4,112 |
| Other non-operating income, net | 210 |
| Interest expense | (69) |
| | ----- |
| Income from continuing operations before income taxes | 4,253 |
| Provision for income taxes | 2,041 |
| | ----- |
| Income from continuing operations | 2,212 |
| Discontinued operations, net of tax | (477) |
| | ----- |
| Net income | \$ 1,735 |
| | ===== |
| Basic and diluted earnings (loss) per common share: | |
| Continuing operations | \$.14 |
| Discontinued operations | (.03) |
| | ----- |
| | \$.11 |
| | ===== |

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| | |
|--|------------------|
| Cash dividends per share | \$.125 ===== |
| Shares used in the calculation of basic and diluted earnings per share | 15,216 ===== |

See accompanying notes to consolidated financial statements.

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COMPX INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

| | 2005 ----- |
|---|------------------|
| Net income | \$1,735 ----- |
| Other comprehensive income, net of tax: | |
| Currency translation adjustment: | |
| Arising during the period | 358 |
| Disposal of business unit | 739 |
| | ----- 1,097 |
| Impact from cash flow hedges, net | (75) ----- |
| Total other comprehensive income | 1,022 ----- |
| Comprehensive income | \$2,757 ===== |

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See accompanying notes to consolidated financial statements.

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COMPX INTERNATIONAL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Three months ended March 31, 2005 and 2006

(In thousands)

(Unaudited)

| | 2005 ---- |
|--|--------------|
| Cash flows from operating activities: | |
| Net income | \$ 1,73 |
| Depreciation and amortization | 2,70 |
| Deferred income taxes: | |
| Continuing operations | 6 |
| Discontinued operations | (18) |
| Other, net | 87 |
| Change in assets and liabilities: | |
| Accounts receivable | (2,34) |
| Inventories | (4) |
| Accounts payable and accrued liabilities | 60 |
| Accounts with affiliates | 17 |
| Income taxes | (1,73) |
| Other, net | 8 |
| | ----- |
| Net cash provided by operating activities | 1,94 |
| | ----- |
| Cash flows from investing activities: | |
| Capital expenditures | (5,14) |
| Proceeds from disposal of assets held for sale | 18,09 |
| Cash of disposed business unit | (4,00) |
| Other, net | |
| | ----- |
| Net cash provided (used) by investing activities | 8,94 |
| | ----- |
| Cash flows from financing activities: | |
| Indebtedness: | |
| Principal payments | (1) |
| Deferred financing costs paid | (2) |
| Dividends | (1,89) |
| Issuance of common stock | 19 |
| | ----- |
| Net cash used by financing activities | (1,74) |
| | ----- |
| Cash and cash equivalents - net change from: | |
| Operating, investing and financing activities | 9,1 |

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| | |
|---|---------|
| Currency translation | 2 |
| Cash and cash equivalents at beginning of period | 21,0 |
| | ----- |
| Cash and cash equivalents at end of period | \$ 30,4 |
| | ===== |
| Supplemental disclosures: | |
| Cash paid for: | |
| Interest | \$ |
| Income taxes | 2,8 |
| Noncash investing activity - note receivable received upon disposal of business unit | \$ 4,1 |

See accompanying notes to consolidated financial statements.

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COMPX INTERNATIONAL INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Three months ended March 31, 2006

(In thousands)

(Unaudited)

| | Common Stock | | Additional paid-in capital | Retained Earnings | Accumulate comprehe incom |
|---------------------------------|--------------|---------|----------------------------------|----------------------|---------------------------------|
| | Class A | Class B | | | Currency translation |
| | ----- | ----- | ----- | ----- | ----- |
| Balance at December 31, 2005 | \$52 | \$100 | \$109,556 | \$31,320 | \$8,961 |
| Net income | - | - | - | 2,473 | - |
| Other comprehensive income, net | - | - | - | - | 361 |
| Cash dividends | - | - | - | (1,904) | - |
| | --- | --- | ----- | ----- | ----- |
| Balance at March 31, 2006 | \$52 | \$100 | \$109,556 | \$31,889 | \$9,322 |
| | === | ==== | ===== | ===== | ===== |

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See accompanying notes to consolidated financial statements.

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COMPX INTERNATIONAL INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1 - Basis of presentation and accounting principles newly adopted in 2006:

The consolidated balance sheet of CompX International Inc. and Subsidiaries (collectively, the "Company") at December 31, 2005 has been condensed from the Company's audited consolidated financial statements at that date. The consolidated balance sheet at March 31, 2006 and the consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the interim periods ended March 31, 2005 and 2006 have been prepared by the Company, without audit. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the consolidated financial position, results of operations and cash flows have been made. The results of operations for the interim periods are not necessarily indicative of the operating results for a full year or of future operations. The year-end balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America ("GAAP"). Certain information normally included in financial statements prepared in accordance with GAAP has been condensed or omitted. The accompanying consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (the "2005 Annual Report").

Basic earnings per share of common stock is based upon the weighted average number of common shares actually outstanding during each period. Diluted earnings per share of common stock includes the impact of outstanding dilutive stock options.

Commitments and contingencies are discussed in the 2005 Annual Report.

At March 31, 2006, CompX Group, Inc., a majority-owned subsidiary of NL Industries, Inc. (NYSE: NL) owned 83% of the Company's outstanding common stock. NL owns 82% of CompX Group, and a wholly owned subsidiary of Titanium Metals Corporation (NYSE:TIE) ("TIMET") owns the remaining 18% of CompX Group. At March 31, 2006, (i) NL and TIMET own an additional 2% and 3% respectively of CompX directly, (ii) Valhi, Inc. (NYSE: VHI) holds, directly or through a subsidiary, approximately 83% of NL's outstanding common stock and approximately 37% of TIMET's outstanding common stock and (iii) Contran Corporation holds, directly or through subsidiaries, approximately 92% of Valhi's outstanding common stock. Substantially all of Contran's outstanding voting stock is held by trusts established for the benefit of certain children and grandchildren of Harold C. Simmons, of which Mr. Simmons is sole trustee, or is held by Mr. Simmons or persons or other entities related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control each of such companies and the Company.

Inventory costs. The Company adopted SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, for inventory costs incurred on or after January 1, 2006. SFAS No. 151 requires that the allocation of fixed production overhead costs to inventory shall be based on normal capacity. Normal capacity is not defined as a fixed amount; rather, normal capacity refers to a range of production levels expected to be achieved over a number of periods under normal circumstances, taking into account the loss of capacity resulting from planned

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maintenance shutdowns. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of idle plant or production levels below the low end of normal capacity, but instead a portion of fixed overhead

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costs are charged to expense as incurred. Alternatively, in periods of production above the high end of normal capacity, the amount of fixed overhead costs allocated to each unit of production is decreased so that inventories are not measured above cost. SFAS No. 151 also clarifies existing GAAP to require that abnormal freight and wasted materials (spoilage) are to be expensed as incurred. The Company believes its production cost accounting already complies with the requirements of SFAS No. 151; therefore, the effect on the consolidated financial statements as a result of the adoption of SFAS No. 151 was immaterial.

Stock options. In accordance with regulations set forth by the SEC, the Company adopted SFAS No. 123R, Share-Based Payment, as of January 1, 2006. Upon adoption of SFAS No. 123R, the Company will generally be required to recognize the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, with the cost recognized over the period during which an employee is required to provide services in exchange for the award (generally, the vesting period of the award). No compensation cost will be recognized in the aggregate for equity instruments for which the employee does not render the requisite service (generally, if the instrument is forfeited before it has vested). The grant-date fair value will be estimated using option-pricing models (e.g. Black-Sholes or a lattice model). Under the transition alternatives permitted under SFAS No. 123R, the Company will apply the new standard to all new awards granted on or after January 1, 2006, and to all awards existing as of December 31, 2005 which are subsequently modified, repurchased or cancelled. Additionally, as of January 1, 2006, the Company will be required to recognize compensation cost previously measured under SFAS No. 123 for the portion of any non-vested award existing as of December 31, 2005 over the remaining vesting period. Because the number of non-vested awards as of December 31, 2005 with respect to options granted by the Company was not material, the effect of adopting SFAS No. 123R, in so far as it relates to the recognition of compensation cost in the Company's consolidated statements of income for existing stock options, did not have a material effect on the Company's consolidated financial statements. Should the Company, however, either grant a significant number of options or modify, repurchase or cancel existing options in the future, the Company could in the future recognize material amounts of compensation cost related to such options in its consolidated financial statements.

Also upon adoption of SFAS No. 123R, the cash income tax benefit resulting from the exercise of stock options in excess of the cumulative income tax benefit related to such options previously recognized for GAAP financial reporting purposes in the Company's consolidated statements of income, if any, will be reflected as a cash inflow from financing activities in the Company's consolidated statements of cash flows, and the Company's cash flows from operating activities will reflect the effect of cash paid for income taxes exclusive of such cash income tax benefit. No stock options were exercised during the first quarter of 2006; therefore, no such income tax benefits have been recognized as a component of cash flows from financing activities at March 31, 2006.

SFAS No. 123R also requires certain expanded disclosures regarding the Company's stock options, and such expanded disclosures were provided in the 2005 Annual Report.

Prior to January 1, 2006, the Company accounted for stock-based employee

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compensation related to stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion ("APBO") No. 25, Accounting for Stock Issued to Employees, and its various interpretations. Under APBO No. 25, no compensation cost was generally recognized for fixed stock options in which the exercise price is greater than or equal to the market price on the grant date. Compensation cost recognized by the Company related to stock options was not significant during the first three months of 2005 or the first three

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months of 2006. If the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation related to stock options for all options granted on or after January 1, 1995, the effect on the Company's results of operations for the first three months of 2005 would not have been material.

Note 2 - Business segment information:

The Company's operating segments are defined as components of its operations about which separate financial information is available that is regularly evaluated by the chief operating decision maker in determining how to allocate resources and in assessing performance. The Company's chief operating decision maker is David A. Bowers, president and chief executive officer of the Company. The Company currently has two operating segments - Security Products and Furniture Components. The Security Products segment, with manufacturing facilities in South Carolina and Illinois, manufactures locking mechanisms and other security products for sale to the mailbox, transportation, furniture, banking, vending and other industries. The Furniture Components segment, with facilities in Canada, Michigan and Taiwan, manufacture a complete line of precision ball bearing slides and ergonomic computer support systems for use in office furniture, computer-related equipment, tool storage cabinets and other applications.

Previously, the Company had three operating segments: Security Products, Precision Slides, and Ergonomics. During the first quarter of 2006, the Company changed its internal management structure such that its precision slides and ergonomics products businesses are now evaluated as a single operating unit (referred to as Furniture Components). Segment information at March 31, 2006 reflects the new internal management structure. Additionally, in prior periods, the reported amount of operating income for each operating segment included an allocation of corporate operating expenses based upon the amount of each segment's net sales. At March 31, 2006, such corporate expenses have not been so allocated but instead are presented as a separate item within operating income. Prior period segment information has been restated to conform to the current period presentation for all items as mentioned above.

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| | 2005 | March |
|---|----------------|-------|
| | ----- | ----- |
| | (In thousands) | |
| Net sales: | | |
| Security Products | \$18,544 | |
| Furniture Components | 28,299 | |
| Other | - | |
| | ----- | |
| Total net sales | \$46,843 | |
| | ===== | |
| Operating income (loss): | | |
| Security Products | \$ 3,255 | |
| Furniture Components | 2,212 | |
| Other | - | |
| Corporate operating expenses | (1,355) | |
| | ----- | |
| Total operating income | 4,112 | |
| Interest expense | (69) | |
| Other non-operating income, net | 210 | |
| | ----- | |
| Income from continuing operations before income taxes | \$ 4,253 | |
| | ===== | |

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The information below provides disclosure of segment information with respect to each year in the three-year period ended December 31, 2005, based on the Company's new operating unit structure.

| | Years ended December 31, | |
|------------------------------|--------------------------|-----------|
| | 2003 | 2004 |
| | ----- | ----- |
| | (In thousands) | |
| Net sales: | | |
| Furniture Components | \$ 97,811 | \$106,750 |
| Security Products | 76,155 | 75,870 |
| Other | - | - |
| | ----- | ----- |
| Total net sales | \$173,966 | \$182,620 |
| | ===== | ===== |
| Operating income (loss): | | |
| Furniture Components | \$ 1,359 | \$ 8,880 |
| Security Products | 11,078 | 11,600 |
| Other | - | - |
| Corporate operating expenses | (3,658) | (5,090) |

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| | | |
|--|-----------|----------|
| | ----- | ----- |
| Total operating income | 8,779 | 15,39 |
| Interest expense | (1,301) | (49 |
| Other non-operating income, net | 1,676 | 2,41 |
| | ----- | ----- |
| Income from continuing operations before income taxes | \$ 9,154 | \$ 17,32 |
| | ===== | ===== |
| Depreciation and amortization: | | |
| Furniture Components | \$ 7,155 | \$ 7,47 |
| Security Products | 4,744 | 4,19 |
| Other | - | |
| Corporate depreciation | 269 | 11 |
| Thomas Regout** | 2,612 | 2,42 |
| | ----- | ----- |
| | \$ 14,780 | \$ 14,20 |
| | ===== | ===== |
| Capital expenditures: | | |
| Furniture Components | \$ 6,446 | \$ 2,52 |
| Security Products | 1,901 | 2,43 |
| Other | - | |
| Thomas Regout** | 561 | 39 |
| | ----- | ----- |
| | \$ 8,908 | \$ 5,34 |
| | ===== | ===== |
| Total assets: | | |
| Furniture Components | \$ 88,928 | \$ 77,71 |
| Security Products | 77,024 | 72,79 |
| Other | - | |
| Thomas Regout** | 38,595 | 28,92 |
| Corporate and eliminations | 6,196 | 6,84 |
| | ----- | ----- |
| | \$210,743 | \$186,27 |
| | ===== | ===== |
| Goodwill: | | |
| Furniture Components | \$ 4,986 | \$ 5,27 |
| Security Products | 23,743 | 23,74 |
| Other | - | - |
| | ----- | ----- |
| | \$ 28,729 | \$ 29,01 |
| | ===== | ===== |

** Denotes disposed segment.

Note 3 - Inventories:

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December 31,
2005

(In thou

| | |
|-------------------|----------|
| Raw materials | \$ 7,098 |
| Work in process | 9,899 |
| Finished products | 5,541 |
| | ----- |
| | \$22,538 |
| | ===== |

Note 4 - Accounts payable and accrued liabilities:

December 31,
2005

(In thou

| | |
|----------------------------|----------|
| Accounts payable | \$ 7,022 |
| Accrued liabilities: | |
| Employee benefits | 8,179 |
| Customer tooling | 1,319 |
| Professional fees | 720 |
| Insurance | 516 |
| Taxes other than on income | 299 |
| Sales rebates | 110 |
| Other | 1,073 |
| | ----- |
| | \$19,238 |
| | ===== |

Note 5 - Indebtedness:

December 31,
2005

(In thou

| | |
|----------------------|----------|
| Other indebtedness | \$1,596 |
| Less current portion | 171 |
| | ----- |
| | \$ 1,425 |
| | ===== |

Other indebtedness at December 31, 2005 includes certain industrial revenue bonds which were prepaid in February 2006 for an amount equal to its carrying value.

Note 6 - Other non-operating income, net:

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| | Three months March 2005 |
|-----------------|-------------------------------|
| | ----- (In thousands) |
| Interest income | \$ 176 |
| Other, net | 34 |
| | ----- |
| | \$ 210 |
| | ===== |

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Note 7 - Provision for income taxes:

| | Three months March 2005 |
|---|-------------------------------|
| | ----- (In thousands) |
| Expected tax expense, at the U.S. federal statutory income tax rate of 35% | \$1,489 |
| Non-U.S. tax rates | (78) |
| Incremental U.S. tax on earnings of foreign Subsidiaries | 572 |
| State income taxes and other, net | 58 |
| Valuation allowance | - |
| | --- |
| | \$2,041 |
| | ===== |

Note 8 - Currency forward exchange contracts:

Certain of the Company's sales generated by its non-U.S. operations are denominated in U.S. dollars. The Company periodically uses currency forward contracts to manage a portion of currency exchange rate market risk associated with receivables, or similar exchange rate risk associated with future sales, denominated in a currency other than the holder's functional currency. The Company has not entered into these contracts for trading or speculative purposes in the past, nor does the Company currently anticipate entering into such contracts for trading or speculative purposes in the future. Derivatives used to hedge forecasted transactions and specific cash flows associated with foreign currency denominated financial assets and liabilities which meet the criteria for hedge accounting are designated as cash flow hedges. Consequently, the effective portion of gains and losses is deferred as a component of accumulated other comprehensive income and is recognized in earnings at the time the hedged item affects earnings. Contracts that do not meet the criteria for hedge accounting are marked-to-market at each balance sheet date with any resulting gain or loss recognized in income currently as part of net currency

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transactions. At March 31, 2006, the Company held a series of contracts to manage such exchange rate risk to exchange an aggregate of U.S. \$5.2 million for Canadian dollars at an exchange rate of Cdn. \$1.16 per U.S. dollar. Such contracts qualify for hedge accounting and mature through June 2006. The exchange rate was Cdn. \$1.17 per U.S. dollar at March 31, 2006. The estimated fair value of such contracts is not material at March 31, 2006.

Note 9 - Discontinued operations:

Discontinued operations relates to the Company's former Thomas Regout operations in the Netherlands. In January 2005, CompX completed the sale of such operations for net proceeds that were approximately \$864,000 less than previously estimated (primarily due to higher expenses associated with the disposal of the Thomas Regout operations), and discontinued operations in the first quarter of 2005 includes a charge related to such differential (\$477,000, net of income tax benefit).

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

The Company reported operating income of \$4.8 million in the first quarter of 2006 compared to operating income of \$4.1 million for the first quarter of 2005. The operating income improved due to a more favorable product mix, the impact of the acquisition of a small components business in August 2005 and the Company's ongoing focus on reducing costs.

Results of Operations

| | Three months ended March 31, | |
|----------------------|---------------------------------|----------|
| | 2005 | 2006 |
| | ---- | ---- |
| | (In millions) | |
| Net sales: | | |
| Security Products | \$18,544 | \$20,417 |
| Furniture Components | 28,299 | 23,745 |
| Other | - | 2,867 |
| | ----- | ----- |
| Total net sales | \$46,843 | \$47,029 |