

COMPX INTERNATIONAL INC  
Form 10-Q  
November 03, 2011  
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# 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 September 30, 2011

Commission file number 1-13905

## COMPX INTERNATIONAL INC.

(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
Incorporation or organization)

57-0981653  
(IRS Employer  
Identification No.)

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5430 LBJ Freeway, Suite 1700,

Three Lincoln Centre, Dallas, Texas  
(Address of principal executive offices)

75240-2697  
(Zip Code)

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

Indicate by checkmark:

Whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such a shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Number of shares of common stock outstanding on October 28, 2011:

|          |            |
|----------|------------|
| Class A: | 2,386,107  |
| Class B: | 10,000,000 |

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Items 2, 3, 4 and 5 of Part II are omitted because there is no information to report.

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**COMPX INTERNATIONAL INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands)

|                                   | December 31,<br>2010 | September 30,<br>2011<br>(unaudited) |
|-----------------------------------|----------------------|--------------------------------------|
| <b>ASSETS</b>                     |                      |                                      |
| Current assets:                   |                      |                                      |
| Cash and cash equivalents         | \$ 13,919            | \$ 8,533                             |
| Accounts receivable, net          | 14,601               | 16,625                               |
| Inventories, net                  | 18,424               | 19,982                               |
| Prepaid and other                 | 1,050                | 1,287                                |
| Deferred income taxes             | 2,366                | 2,352                                |
| Promissory note receivable        | 15,000               | 15,000                               |
| <b>Total current assets</b>       | <b>65,360</b>        | <b>63,779</b>                        |
| Other assets:                     |                      |                                      |
| Goodwill                          | 31,452               | 34,026                               |
| Other intangible assets           | 840                  | 2,279                                |
| Assets held for sale              | 2,415                | 6,661                                |
| Other assets                      | 102                  | 94                                   |
| <b>Total other assets</b>         | <b>34,809</b>        | <b>43,060</b>                        |
| Property and equipment:           |                      |                                      |
| Land                              | 12,646               | 11,242                               |
| Buildings                         | 39,934               | 32,148                               |
| Equipment                         | 123,725              | 123,292                              |
| Construction in progress          | 965                  | 1,122                                |
|                                   | 177,270              | 167,804                              |
| Less accumulated depreciation     | 117,367              | 116,709                              |
| <b>Net property and equipment</b> | <b>59,903</b>        | <b>51,095</b>                        |
| <b>Total assets</b>               | <b>\$ 160,072</b>    | <b>\$ 157,934</b>                    |

**Table of Contents****COMPX INTERNATIONAL INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)****(In thousands)**

|   | <b>December 31,<br/>2010</b> | <b>September 30,<br/>2011<br/>(unaudited)</b> |
|---|------------------------------|---|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>    |                              |   |
| Current liabilities:                          |                              |   |
| Current maturities of long-term debt          | \$ 1,000                     | \$ 5,842                                      |
| Accounts payable and accrued liabilities      | 16,182                       | 14,896  |
| Interest payable to affiliate                 | 876                          | 3   |
| Income taxes payable to affiliate             | 1,087                        | 1,174   |
| Income taxes                                  | 907                          | 1,436   |
| <br>Total current liabilities                 | <br>20,052                   | <br>23,351                                    |
| Noncurrent liabilities:                       |                              |   |
| Long-term debt                                | 44,230                       | 36,480  |
| Deferred income taxes                         | 11,889                       | 12,834  |
| Other noncurrent liabilities                  | 6                            | 775   |
| <br>Total noncurrent liabilities              | <br>56,125                   | <br>50,089                                    |
| Stockholders equity:                          |                              |   |
| Preferred stock                               |                              |   |
| Class A common stock                          | 24                           | 24  |
| Class B common stock                          | 100                          | 100   |
| Additional paid-in capital                    | 54,982                       | 55,153  |
| Retained earnings                             | 16,486                       | 18,551  |
| Accumulated other comprehensive income        | 12,303                       | 10,666  |
| <br>Total stockholders equity                 | <br>83,895                   | <br>84,494                                    |
| <br>Total liabilities and stockholders equity | <br>\$ 160,072               | <br>\$ 157,934                                |
| Commitments and contingencies (Note 9)        |                              |   |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****COMPX INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share data)**

|  | Three months ended<br>September 30, |                  | Nine months ended<br>September 30, |                   |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
|  | 2010                                | 2011             | 2010                               | 2011              |
|  | (unaudited)                         |                  |                                    |                   |
| Net sales  | \$ 35,740                           | <b>\$ 35,736</b> | \$ 102,924                         | <b>\$ 105,755</b> |
| Cost of goods sold   | 26,042                              | <b>27,202</b>    | 75,272                             | <b>78,704</b>     |
| Gross profit   | 9,698                               | <b>8,534</b>     | 27,652                             | <b>27,051</b>     |
| Selling, general and administrative expense                          | 5,901                               | <b>5,745</b>     | 17,239                             | <b>17,807</b>     |
| Other operating income (expense):                                    |                                     |                  |                                    |                   |
| Assets held for sale write-down                                      | (500)                               | <b>(1,135)</b>   | (500)                              | <b>(1,135)</b>    |
| Litigation settlement gain   |                                     |                  |                                    | <b>7,468</b>      |
| Litigation expense   | (158)                               |                  | (2,100)                            | <b>(227)</b>      |
| Facility consolidation costs   |                                     | <b>(175)</b>     |                                    | <b>(1,973)</b>    |
| Operating income   | 3,139                               | <b>1,479</b>     | 7,813                              | <b>13,377</b>     |
| Other non-operating income, net                                      | 119                                 | <b>127</b>       | 221                                | <b>385</b>        |
| Interest expense   | (263)                               | <b>(218)</b>     | (683)                              | <b>(617)</b>      |
| Income before income taxes   | 2,995                               | <b>1,388</b>     | 7,351                              | <b>13,145</b>     |
| Provision for income taxes   | 1,325                               | <b>302</b>       | 4,924                              | <b>6,437</b>      |
| Net income   | \$ 1,670                            | <b>\$ 1,086</b>  | \$ 2,427                           | <b>\$ 6,708</b>   |
| Basic and diluted income per common share                            | \$ .13                              | <b>\$ .09</b>    | \$ .20                             | <b>\$ .54</b>     |
| Cash dividends per share   | \$ .125                             | <b>\$ .125</b>   | \$ .375                            | <b>\$ .375</b>    |
| Shares used in the calculation of basic and diluted income per share | 12,375                              | <b>12,386</b>    | 12,373                             | <b>12,381</b>     |

See accompanying Notes to Condensed Consolidated Financial Statements.

**Table of Contents****COMPX INTERNATIONAL INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

|   | <b>Nine months ended<br/>September 30,<br/>2010                      2011<br/>(unaudited)</b> |          |
|---|---|----------|
| <b>Cash flows from operating activities:</b>                            |   |          |
| Net income  | \$ 2,427  | \$ 6,708 |
| Depreciation and amortization   | 5,871   | 5,259    |
| Assets held for sale write-down   | 500   | 1,135    |
| Deferred income taxes   | (421)   | 885      |
| Other, net  | 560   | 488      |
| <b>Change in assets and liabilities (net of effect of acquisition):</b> |   |          |
| Accounts receivable, net  | (5,784)   | (1,886)  |
| Inventories, net  | (2,144)   | (872)    |
| Accounts payable and accrued liabilities                                | 270   | (3,176)  |
| Accounts with affiliates  | 3,090   | 141      |
| Income taxes  | 2,360   | 585      |
| Other, net  | (910)   | (950)    |
| <br>  |   |          |
| Net cash provided by operating activities                               | 5,819   | 8,317    |
| <br>  |   |          |
| <b>Cash flows from investing activities:</b>                            |   |          |
| Capital expenditures  | (1,472)   | (1,772)  |
| Acquisition, net of cash acquired                                       |   | (4,903)  |
| <b>Note receivable from affiliate:</b>                                  |   |          |
| Advances  | (9,000)   |          |
| Collections   | 9,000   |          |
| Purchase of promissory note receivable                                  | (15,000)  |          |
| Proceeds from sale of fixed assets                                      |   | 151      |
| <br>  |   |          |
| Net cash used in investing activities                                   | (16,472)  | (6,524)  |
| <br>  |   |          |
| <b>Cash flows from financing activities:</b>                            |   |          |
| Borrowing under long-term debt  | 5,000   | 5,294    |
| Repayment of long-term debt   |   | (3,006)  |
| Repayment of loan from affiliate  |   | (4,750)  |
| Dividends paid  | (4,640)   | (4,643)  |
| Other, net  | (28)  | 171      |
| <br>  |   |          |
| Net cash provided by (used in) financing activities                     | 332   | (6,934)  |
| <br>  |   |          |
| <b>Cash and cash equivalents net change from:</b>                       |   |          |
| Operating, investing and financing activities                           | (10,321)  | (5,141)  |
| Currency translation  | 185   | (245)    |
| Cash and cash equivalents at beginning of period                        | 20,788  | 13,919   |

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|  |           |          |
|--|-----------|----------|
| Cash and cash equivalents at end of period                                 | \$ 10,652 | \$ 8,533 |
| Supplemental disclosures cash paid (received) for:                         |           |          |
| Interest   | \$ 194    | \$ 1,402 |
| Income taxes paid, net   | (98)      | 4,850    |
| Non-cash investing and financing activity Accrual for capital expenditures | \$ 54     | \$ 320   |

See accompanying Notes to Condensed Consolidated Financial Statements.



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## COMPX INTERNATIONAL INC.

## CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME

Nine months ended September 30, 2011

(In thousands)

(unaudited)

|                               | Common Stock |         | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated other<br>comprehensive income |                        | Total<br>stockholders<br>equity | Comprehensive<br>income |
|-------------------------------|--------------|---------|----------------------------------|----------------------|---|------------------------|---------------------------------|-------------------------|
|                               | Class A      | Class B |                                  |                      | Currency<br>translation                   | Hedging<br>derivatives |                                 |                         |
| Balance at December 31, 2010  | \$ 24        | \$ 100  | \$ 54,982                        | \$ 16,486            | \$ 12,303                                 | \$                     | \$ 83,895                       |                         |
| Net income                    |              |         |                                  | 6,708                |   |                        | 6,708                           | \$ 6,708                |
| Other comprehensive loss, net |              |         |                                  |                      | (997)                                     | (640)                  | (1,637)                         | (1,637)                 |
| Issuance of common stock      |              |         | 171                              |                      |   |                        | 171                             |                         |
| Cash dividends                |              |         |                                  | (4,643)              |   |                        | (4,643)                         |                         |
| Balance at September 30, 2011 | \$ 24        | \$ 100  | \$ 55,153                        | \$ 18,551            | \$ 11,306                                 | \$ (640)               | \$ 84,494                       |                         |
| Comprehensive income          |              |         |                                  |                      |   |                        |                                 | \$ 5,071                |

See accompanying Notes to Condensed Consolidated Financial Statements.

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**COMPX INTERNATIONAL INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2011**

**(unaudited)**

**Note 1 Organization and basis of presentation:**

*Organization.* We (AMEX: CIX) are 87% owned by NL Industries, Inc. (NYSE: NL) at September 30, 2011. We manufacture and sell component products (security products, precision ball bearing slides, ergonomic computer support systems, and performance marine components). At September 30, 2011, (i) Valhi, Inc. (NYSE: VHI) held approximately 83% of NL's outstanding common stock and (ii) subsidiaries of Contran Corporation (Contran) held approximately 94% 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 directly by Mr. Simmons or other persons or companies related to Mr. Simmons. Consequently, Mr. Simmons may be deemed to control each of the companies and us.

*Basis of presentation.* Consolidated in this Quarterly Report are the results of CompX International Inc. and its subsidiaries. The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 that we filed with the Securities and Exchange Commission (SEC) on March 2, 2011 (the 2010 Annual Report). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2010 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2010) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Our results of operations for the interim periods ended September 30, 2011 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2010 Consolidated Financial Statements contained in our 2010 Annual Report.

Unless otherwise indicated, references in this report to we, us or our refer to CompX International Inc. and its subsidiaries, taken as a whole.

**Table of Contents****Note 2 Business segment information:**

|                                   | Three months ended    |                  | Nine months ended     |                   |
|-----------------------------------|-----------------------|------------------|-----------------------|-------------------|
|                                   | September 30,<br>2010 | 2011             | September 30,<br>2010 | 2011              |
| (In thousands)                    |                       |                  |                       |                   |
| Net sales:                        |                       |                  |                       |                   |
| Security Products                 | \$ 17,723             | \$ 18,077        | \$ 51,740             | \$ 54,261         |
| Furniture Components              | 16,119                | 15,588           | 44,504                | 44,630            |
| Marine Components                 | 1,898                 | 2,071            | 6,680                 | 6,864             |
| <b>Total net sales</b>            | <b>\$ 35,740</b>      | <b>\$ 35,736</b> | <b>\$ 102,924</b>     | <b>\$ 105,755</b> |
| Operating income:                 |                       |                  |                       |                   |
| Security Products                 | \$ 3,680              | \$ 3,550         | \$ 10,261             | \$ 10,911         |
| Furniture Components *            | 1,630                 | 711              | 2,715                 | 8,351             |
| Marine Components                 | (393)                 | (252)            | (840)                 | (664)             |
| Corporate operating expense **    | (1,778)               | (2,530)          | (4,323)               | (5,221)           |
| <b>Total operating income</b>     | <b>3,139</b>          | <b>1,479</b>     | <b>7,813</b>          | <b>13,377</b>     |
| Other non-operating income, net   | 119                   | 127              | 221                   | 385               |
| Interest expense                  | (263)                 | (218)            | (683)                 | (617)             |
| <b>Income before income taxes</b> | <b>\$ 2,995</b>       | <b>\$ 1,388</b>  | <b>\$ 7,351</b>       | <b>\$ 13,145</b>  |

Intersegment sales are not material.

\* Furniture Components operating income includes the following:

a patent litigation settlement gain of \$7.5 million in the first quarter of 2011 discussed in Note 9;

facility consolidation costs of approximately \$175,000 and \$2.0 million for the third quarter and first nine months of 2011, respectively, as discussed in Note 7; and

patent litigation expenses of \$158,000 and \$2.1 million in the third quarter and first nine months of 2010 compared to nil and \$227,000 in the same comparative periods for 2011.

\*\* Corporate operating expenses include a write-down on assets held for sale of approximately \$500,000 in the third quarter and first nine months of 2010 compared to a \$1.1 million write-down on assets held for sale in the same comparative periods for 2011. See Note 7. On July 29, 2011, we completed the acquisition of 100% of the stock of a Canadian ergonomic component products company for initial cash consideration of the equivalent of approximately \$4.9 million, net of approximately \$3,000 of cash acquired, with potential additional cash consideration ranging from nil to approximately \$1.5 million payable in the first quarter of 2013, contingent upon the acquired business achieving certain acquired product line sales targets during 2012. The estimated fair value of the contingent consideration recognized at the date

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of acquisition was \$761,000. The acquisition is intended to expand our Furniture Components ergonomics product line. We have included the results of operations and cash flows of the acquired business in our Condensed Consolidated Financial Statements subsequent to the acquisition date. The purchase price has been preliminarily allocated among net assets acquired (pending completion of the final valuation), consisting of (i) net working capital (receivable, inventory and payables) of \$950,000, (ii) identifiable intangibles other than goodwill of \$2.0 million, (iii) goodwill of \$3.0 million and (iv) deferred

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income tax liabilities of \$450,000. The tangible and intangible net assets acquired (other than goodwill) were valued based upon a preliminary estimate of the fair value of such net assets, with the remainder of the purchase price allocated to goodwill. The business had net sales of \$4.2 million in 2010 and the pro-forma effect to us, assuming this acquisition had been completed as of January 1, 2011, is not material.

**Note 3 Inventories, net:**

|                               | December 31,<br>2010 | September 30,<br>2011 |
|-------------------------------|----------------------|-----------------------|
|                               | (In thousands)       |                       |
| Raw materials:                |                      |                       |
| Security Products             | \$ 2,174             | \$ 2,463              |
| Furniture Components          | 3,325                | 3,711                 |
| Marine Components             | 894                  | 1,047                 |
| <b>Total raw materials</b>    | <b>6,393</b>         | <b>7,221</b>          |
| Work-in-process:              |                      |                       |
| Security Products             | 5,178                | 5,634                 |
| Furniture Components          | 1,068                | 1,031                 |
| Marine Components             | 434                  | 440                   |
| <b>Total work-in-process</b>  | <b>6,680</b>         | <b>7,105</b>          |
| Finished goods:               |                      |                       |
| Security Products             | 1,720                | 1,676                 |
| Furniture Components          | 2,717                | 3,248                 |
| Marine Components             | 914                  | 732                   |
| <b>Total finished goods</b>   | <b>5,351</b>         | <b>5,656</b>          |
| <b>Total inventories, net</b> | <b>\$ 18,424</b>     | <b>\$ 19,982</b>      |

**Note 4 Accounts payable and accrued liabilities:**

|                            | December 31,<br>2010 | September 30,<br>2011 |
|----------------------------|----------------------|-----------------------|
|                            | (In thousands)       |                       |
| Accounts payable           | \$ 4,890             | \$ 4,409              |
| Accrued liabilities:       |                      |                       |
| Employee benefits          | 8,345                | 6,959                 |
| Forward currency contracts |                      | 713                   |
| Taxes other than on income | 479                  | 698                   |
| Insurance                  | 641                  | 427                   |
| Customer tooling           | 561                  | 348                   |
| Professional               | 487                  | 302                   |
| Other                      | 779                  | 1,040                 |

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|       |           |                  |
|-------|-----------|------------------|
| Total | \$ 16,182 | \$ <b>14,896</b> |
|-------|-----------|------------------|

**Table of Contents****Note 5 Long-term debt:**

|                                      | December 31,<br>2010 | September 30,<br>2011 |
|--------------------------------------|----------------------|-----------------------|
|                                      | (In thousands)       |                       |
| Revolving bank credit facility       | \$ 3,000             | \$ 4,842              |
| Promissory note payable to affiliate | 42,230               | 37,480                |
| <b>Total debt</b>                    | <b>45,230</b>        | <b>42,322</b>         |
| Less current maturities              | 1,000                | 5,842                 |
| <b>Total long-term debt</b>          | <b>\$ 44,230</b>     | <b>\$ 36,480</b>      |

In February 2011, we repaid all of the \$3.0 million which was outstanding at December 31, 2010 on the revolving credit facility. In July 2011, we borrowed the equivalent of approximately \$5.3 million under our revolving credit facility in connection with the acquisition discussed in Note 2 (such borrowing was denominated in Canadian dollars, as permitted by the terms of the credit facility). Of the current maturities, \$4.8 million relates to our revolving bank credit facility and \$1.0 million relates to our note payable to affiliate discussed below.

The promissory note payable to affiliate was amended in September 2009 resulting in the deferral of interest payments and postponement of quarterly principal payments on the promissory note until March 2011. As such, in March 2011 we paid our required quarterly principal payment of \$250,000 and all accrued interest totaling approximately \$1.0 million. In addition, we prepaid \$4.0 million in principal on the promissory note. In the second and third quarters of 2011, we continued our regularly scheduled quarterly principal payment of \$250,000 and related accrued interest for each quarter. The interest rate on the promissory note at September 30, 2011 was 1.2%.

In October 2011, we collected the \$15.0 million principal amount due to us under our promissory note receivable, and subsequently made an additional \$15.0 million prepayment on our promissory note payable to affiliate.

**Note 6 Provision for income taxes:**

|  | Nine months ended<br>September 30,<br>2010      2011 |                 |
|--|--|-----------------|
|  | (In thousands)                                       |                 |
| Expected tax expense, at the U.S. federal statutory income tax rate of 35% | \$ 2,573   | \$ 4,600        |
| Non U.S. tax rates   | (358)  | (899)           |
| Incremental U.S. tax on earnings of non-U.S. subsidiaries                  | 2,864  | 2,694           |
| State income taxes and other, net  | (155)  | 42              |
| <b>Total income tax expense</b>  | <b>\$ 4,924</b>                                      | <b>\$ 6,437</b> |

In the first quarter of 2011, we recognized a \$2.1 million provision for deferred income taxes related to the undistributed earnings of our Canadian subsidiary attributable to the \$7.5 million patent litigation settlement gain discussed in Note 9.

Under GAAP, we are required to recognize a deferred income tax liability with respect to the incremental U.S. (federal and state) and foreign withholding taxes that would be incurred when undistributed earnings of a foreign subsidiary are subsequently repatriated, unless management has





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determined that those undistributed earnings are permanently reinvested for the foreseeable future. Prior to March 31, 2010, we had not recognized a deferred income tax liability related to incremental income taxes on the pre-2005 undistributed earnings of our Taiwanese subsidiary, as those earnings were deemed to be permanently reinvested. We are required to reassess the permanent reinvestment conclusion on an ongoing basis to determine if our intentions have changed. At the end of March 2010, and based primarily upon changes in our cash management plans, we determined that all of the undistributed earnings of our Taiwanese subsidiary can no longer be considered to be permanently reinvested in Taiwan. Accordingly, in the first quarter of 2010 we recognized an aggregate \$1.9 million provision for deferred income taxes on the pre-2005 undistributed earnings of our Taiwanese subsidiary. Consequently, all of the undistributed earnings of our non-U.S. operations are now considered to be not permanently reinvested.

**Note 7 Facility consolidation costs:**

In November 2010, management approved a restructuring plan for our Furniture Components segment to move precision slide production from our Byron Center, Michigan facility to our other precision slide manufacturing facilities in Kitchener, Ontario and Taipei, Taiwan. The move, which was substantially completed in April 2011, reduced the facilities where we produce precision slides from three to two and is expected to enhance the operating efficiency of our precision slide production capacity. As of September 30, 2011, approximately \$191,000 of severance costs and approximately \$2.0 million of machinery and equipment relocation costs from the Byron Center facility to the Kitchener facility had been expensed, mostly in the first six months of 2011. No additional severance and equipment relocation costs are expected to be incurred subsequent to September 30, 2011.

At the time management approved the Furniture Components restructuring discussed above in November 2010, we intended to continue to utilize the Byron Center facility for light assembly and warehousing of product to service our U.S. customers. After operating the facility from the first quarter of 2011 to the latter part of the third quarter of 2011, we determined that continued use of the Byron Center facility for warehousing and light assembly was no longer necessary to serve our U.S. customers. Accordingly, in September 2011 management made the decision to sell the facility, at which time such facility met all of the criteria under GAAP to be classified as an asset held for sale. In classifying the facility (land and building) as held for sale, we concluded that the carrying amount of the assets exceeded the estimated fair value less costs to sell such assets. In determining the estimated fair value of such assets, we obtained an independent appraisal. Based on this appraisal, we recognized a write-down of \$910,000 during the third quarter of 2011 to reduce the carrying value of the asset to its estimated fair value less cost to sell.

At September 30, 2011 our assets held for sale consisted of the Byron Center facility discussed above and two additional properties (primarily land, building and building improvements) formerly used in our operations. These assets were classified as assets held for sale when they ceased to be used in our operations and met all of the applicable criteria under GAAP. During the third quarter of 2011 due to continued negative local market conditions, we obtained an updated independent appraisal for the River Grove facility, the most significant of these two properties. Based on this appraisal, we recognized an additional write-down of \$225,000 during the third quarter of 2011 to reduce the carrying value of that asset to its estimated fair value less cost to sell.

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These write-downs totaled \$1.1 million in the third quarter of 2011 and are included in corporate operating expense. The appraisals represent a Level 2 input as defined by ASC 820-10-35. The carrying value of the remaining property is not significant. All three properties are being actively marketed; however, due to the current state of the commercial real estate market, we can not be certain of the timing of the disposition of these assets.

**Note 8 Financial instruments:**

The following table presents the financial instruments that are not carried at fair value but which require fair value disclosure:

|   | December 31,<br>2010 |               | September 30,<br>2011 |               |
|---|----------------------|---------------|-----------------------|---------------|
|   | Carrying<br>amount   | Fair<br>value | Carrying<br>amount    | Fair<br>value |
|   | (In thousands)       |               |                       |               |
| Cash and cash equivalents                     | \$ 13,919            | \$ 13,919     | \$ 8,533              | \$ 8,533      |
| Accounts receivable, net                      | 14,601               | 14,601        | 16,625                | 16,625        |
| Promissory note receivable                    | 15,000               | 15,000        | 15,000                | 15,000        |
| Accounts payable                              | 4,890                | 4,890         | 4,409                 | 4,409         |
| Long-term debt (including current maturities) | 45,230               | 45,230        | 42,322                | 42,322        |

Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value. The fair values of our variable-rate promissory note receivable and long-term debt are deemed to approximate book value. The fair values of our promissory note receivable and long-term debt are Level 2 inputs as defined by ASC Topic 820-10-35.

We periodically use 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. We have not entered into these contracts for trading or speculative purposes in the past, nor do we anticipate entering into such contracts for trading or speculative purposes in the future. Most of our currency forward contracts meet the criteria for hedge accounting under GAAP and are designated as cash flow hedges. For these currency forward contracts, gains and losses representing the effective portion of our hedges are deferred as a component of accumulated other comprehensive income, and are subsequently recognized in earnings at the time the hedged item affects earnings. Occasionally, we enter into currency forward contracts which do not meet the criteria for hedge accounting. For these contracts, we mark-to-market the estimated fair value of the contracts at each balance sheet date based on quoted market prices for the forward contracts, with any resulting gain or loss recognized in income currently as part of net currency transactions. The quoted market prices for the forward contracts are a Level 1 input as defined by ASC Topic 820-10-35.

At September 30, 2011, we held a series of contracts to exchange an aggregate of U.S. \$22.4 million for an equivalent value of Canadian dollars at exchange rates ranging from Cdn. \$1.03 to Cdn. \$0.99 per U.S. dollar. These contracts qualified for hedge accounting and mature through December 2012. The exchange rate was \$1.03 per U.S. dollar at September 30, 2011. The estimated fair value of the contracts was a liability of approximately \$713,000 at September 30, 2011. We had no currency forward contracts outstanding at December 31, 2010.

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### **Note 9 Commitments and contingencies:**

*Legal proceedings.* Prior to March 9, 2011, we were involved in certain patent litigation with a competitor, and in March 2011, we entered into a confidential settlement agreement with the competitor. Under the terms of the agreement, the competitor paid our Canadian subsidiary approximately \$7.5 million in cash (which is recognized as a litigation settlement gain in the first quarter of 2011), and we each agreed to cross-license certain patents and to withdraw certain legal proceedings against the other party.

We are involved, from time to time, in various contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our business. We currently believe the disposition of all claims and disputes, individually or in the aggregate, should not have a material long-term adverse effect on our consolidated financial condition, results of operations or liquidity.

### **Note 10 Recent Accounting Pronouncements:**

In May 2011 the Financial Accounting Standards Board issued Accounting Standards Update ( ASU ) 2011-04, *Amendments to Achieve Common Fair Value Measurements and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 contains technical adjustments and clarifications to more closely align the U.S. GAAP and International Financials Reporting Standards ( IFRS ) for fair value and will be effective for our first quarter 2012 report. We do not believe the adoption of this standard will have a material affect on our Condensed Consolidated Financial Statements.

In June 2011 the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*. ASU 2011-05 will eliminate the option of presenting comprehensive income as a component of the Consolidated Statement of Stockholders Equity and will instead require comprehensive income be presented as a component of the Consolidated Statement of Income or as a separate statement immediately following the Consolidated Statement of Income. Additionally, ASU 2011-05 will require us to present on the face of our financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income where the components of net income and other comprehensive income are presented. This standard will be effective for our first quarter 2012 report. Upon adoption of ASU 2011-05, we intend to present our comprehensive income in a separate Consolidated Statement of Comprehensive Income.

In September of 2011 the FASB issued ASU 2011-08 *Testing Goodwill for Impairment* (the revised standard). ASU 2011-08 provides the option to first assess qualitatively whether events or circumstances exist to indicate a goodwill impairment may be present to determine whether further impairment testing is necessary. This standard will be effective for annual and interim goodwill testing beginning with our first quarter 2012 report, although early adoption is permitted. We do not believe the adoption of this standard will have a material affect on our Condensed Consolidated Financial Statements and we did not avail ourselves of the qualitative goodwill impairment assessment as part of our 2011 annual goodwill impairment analysis conducted during the third quarter.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

We are a leading manufacturer of engineered components utilized in a variety of applications and industries. Through our Security Products Segment we manufacture mechanical and electronic cabinet locks and other locking mechanisms used in postal, office and institutional furniture, transportation, vending, tool storage and general cabinetry applications. Our Furniture Components Segment manufactures precision ball bearing slides and ergonomic computer support systems used in office and institutional furniture, home appliances, tool storage and a variety of other applications. We also manufacture stainless steel exhaust systems, gauges and electronic and mechanical throttle controls for the performance boat industry through our Marine Components Segment.

We reported operating income of \$1.5 million in the third quarter of 2011 compared to \$3.1 million in the same period of 2010. We reported operating income of \$13.4 million for the nine-month period ended September 30, 2011 compared to \$7.8 million for the comparable period in 2010. Our operating income decreased in the third quarter of 2011 primarily due to a less favorable product sales mix and higher raw material costs in 2011 compared to 2010 and the negative impact of a write-down on assets held for sale of \$1.1 million in the third quarter of 2011 as compared to a write-down on assets held for sale of \$500,000 in the third quarter of 2010.

Our operating income increased for the nine-month period in 2011 primarily due to the net effects of:

The positive impact of a litigation settlement gain recorded in the first quarter of 2011 as well as the positive impact of lower litigation expense in 2011;

The positive impact of higher sales in the first six months of 2011 from an increase in customer order rates primarily in Security Products due to improved economic conditions in North America;

The negative impact in 2011 of relocation costs and production inefficiencies related to the consolidation of our precision slides facilities;

The negative impact on margins in 2011 from higher raw material costs;

The negative impact of write-downs on assets held for sale, as discussed above; and

The negative impact of relative changes in foreign currency exchange rates in 2011.

**Table of Contents****Results of Operations**

|                                 | 2010      | Three months ended<br>September 30, |           | %    |
|---------------------------------|-----------|-------------------------------------|-----------|------|
|                                 |           | %                                   | 2011      |      |
| (Dollars in thousands)          |           |                                     |           |      |
| Net sales                       | \$ 35,740 | 100%                                | \$ 35,736 | 100% |
| Cost of goods sold              | 26,042    | 73                                  | 27,202    | 76   |
| Gross profit                    | 9,698     | 27                                  | 8,534     | 24   |
| Operating costs and expenses    | 5,901     | 17                                  | 5,745     | 16   |
| Assets held for sale write-down | 500       | 1                                   | 1,135     | 3    |
| Litigation expense              | 158       |                                     |           |      |
| Facility consolidation costs    |           |                                     | 175       |      |
| Operating income                | \$ 3,139  | 9%                                  | \$ 1,479  | 4%   |

|                                 | 2010       | Nine months ended<br>September 30, |            | %    |
|---------------------------------|------------|------------------------------------|------------|------|
|                                 |            | %                                  | 2011       |      |
| (Dollars in thousands)          |            |                                    |            |      |
| Net sales                       | \$ 102,924 | 100%                               | \$ 105,755 | 100% |
| Cost of goods sold              | 75,272     | 73                                 | 78,704     | 74   |
| Gross profit                    | 27,652     | 27                                 | 27,051     | 26   |
| Operating costs and expenses    | 17,239     | 17                                 | 17,807     | 17   |
| Litigation settlement gain      |            |                                    | (7,468)    | (7)  |
| Litigation expense              | 2,100      | 2                                  | 227        |      |
| Assets held for sale write-down | 500        |                                    | 1,135      | 1    |
| Facility consolidation costs    |            |                                    | 1,973      | 2    |
| Operating income                | \$ 7,813   | 8%                                 | \$ 13,377  | 13%  |

*Net sales.* Net sales in the third quarter of 2011 were comparable to the third quarter of 2010, and increased 3% in the first nine months of 2011 as compared to the same periods of 2010. Net sales increased in the nine month period due to an increase in order rates from many of our customers during the first half of 2011 resulting from improving economic conditions in North America. Sales related to the July 2011 acquisition of an ergonomics component products business were not significant to the third quarter and nine-month periods of 2011. See Notes 2 and 5 to our Condensed Consolidated Financial Statements. For the nine-month period comparison, our Security Products, Furniture Components and Marine Components Segments accounted for approximately 89%, 4% and 7%, respectively, of the total increase in sales. Security Products sales represented the largest percentage of the total increase in sales due to stronger sales to customers in the transportation market.

*Cost of goods sold and gross profit.* Cost of goods sold as a percentage of sales increased by 3% and 1% in the third quarter and in the first nine months of 2011 compared to the same periods in 2010 resulting in a decrease in gross profit and related margin.

Both the quarter and nine-month period comparisons were negatively impacted by higher raw material costs and the relative changes in currency exchange rates. Additionally, the nine-month period was partially offset by the positive impact of increased leverage of fixed costs from higher sales.



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*Operating costs and expenses.* Operating costs and expenses consist primarily of sales and administrative related personnel costs, sales commissions and marketing expenses, as well as gains and losses on plant, property and equipment and currency transaction gains and losses. As a percentage of net sales, operating costs and expenses were comparable for the third quarter and the nine-month period of 2011 in relation to the same periods in 2010.

*Litigation.* The litigation settlement gain recorded in the first quarter 2011 of approximately \$7.5 million is discussed in Note 9 to the Condensed Consolidated Financial Statements. Additionally, as a result of the settlement, legal expenses decreased approximately \$158,000 and \$1.9 million for the third quarter and first nine-month period of 2011 compared to the same periods of 2010.

*Facility consolidation costs.* Our Furniture Components segment recorded approximately \$175,000 and \$2.0 million in relocation costs for the third quarter and for the nine-month period, respectively, as a result of consolidating two of our precision slides facilities. See Note 7 to our Condensed Consolidation Financial Statements.

*Assets held for sale write-down.* During the third quarter of 2011, we recorded a write-down on assets held for sale totaling \$1.1 million which is included in corporate operating expense. See Note 7 to the Condensed Consolidated Financial Statements. During the third quarter of 2010, we recorded a write down on assets held for sale of \$500,000.

*Operating income.* Operating income decreased to \$1.5 million for the third quarter of 2011 compared to \$3.1 million for the third quarter of 2010 and improved to \$13.4 million for the first nine months of 2011 compared to \$7.8 million for the same period in 2010. Operating income for the third quarter decreased primarily due to the negative impact of higher raw material costs, a less favorable product sales mix and a \$1.1 million write-down on assets held for sale in the third quarter of 2011 as compared to a \$500,000 write-down on assets held for sale in the third quarter of 2010.

Operating income for the nine month comparative period improved primarily due to the positive impact of the litigation settlement gain in 2011 and lower related litigation expense, partially offset by facility consolidation costs and related production inefficiencies, higher raw material costs, a \$1.1 million write-down on assets held sale in the third quarter of 2011 as compared to a \$500,000 write-down on assets held for sale in the third quarter of 2010 and relative changes in currency exchange rates.

*Currency.* Our Furniture Components Segment has substantial operations and assets which are all located outside the United States (in Canada and Taiwan). The majority of sales generated from our non-U.S. operations are denominated in the U.S. dollar, with the remainder denominated in foreign currencies, principally the Canadian dollar and the New Taiwan dollar. Most raw materials, labor and other production costs for our non-U.S. operations are denominated in local currencies. Consequently, the translated U.S. dollar values of our non-U.S. sales and operating results are subject to currency exchange rate fluctuations which may favorably or unfavorably impact reported earnings and may affect comparability of period-to-period operating results. In addition to the impact of the translation of sales and expenses over time, our non-U.S. operations also generate currency transaction gains and losses which primarily relate to the difference between the currency exchange rates in effect when non-local currency sales or operating costs are initially accrued and when such amounts are settled. Our Furniture Component segment s net

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sales were positively impacted while its operating income was negatively impacted by currency exchange rates in the following amounts as compared to the impact of currency exchange rates during the corresponding periods in the prior year:

**Three months ended September 30, 2011 vs. 2010 (in thousands)**

| Impact on:       | Transaction gains/(losses) |      |        | Translation gain/loss- | Total currency impact 2011 vs. 2010 |
|------------------|----------------------------|------|--------|------------------------|-------------------------------------|
|                  |                            |      |        | impact of rate         |                                     |
|                  | 2010                       | 2011 | Change | changes                |                                     |
| Net Sales        | \$                         |      |        | 159                    | 159                                 |
| Operating income | (127)                      | 369  | 496    | (644)                  | (148)                               |

**Nine months ended September 30, 2011 vs. 2010 (in thousands)**

| Impact on:       | Transaction gains/(losses) |      |        | Translation gain/loss- | Total currency impact 2011 vs. 2010 |
|------------------|----------------------------|------|--------|------------------------|-------------------------------------|
|                  |                            |      |        | impact of rate         |                                     |
|                  | 2010                       | 2011 | Change | changes                |                                     |
| Net Sales        | \$                         |      |        | 491                    | 491                                 |
| Operating income | (60)                       | 412  | 472    | (1,556)                | (1,084)                             |

The positive impact on sales relates to sales denominated in non-U.S. dollar currencies translated into higher U.S. dollar sales due to a strengthening of the local currency in relation to the U.S. dollar. The negative impact on operating income results from the U.S. dollar denominated sales of non-U.S. operations converted into lower local currency amounts due to the weakening of the U.S. dollar. This negatively impacted our gross margin as it results in less local currency generated from sales to cover the costs of non-U.S. operations which are denominated in local currency.

*Provision for income taxes.* A tabular reconciliation between our effective income tax rates and the U.S. federal statutory income tax rate of 35% is included in Note 6 to the Condensed Consolidated Financial Statements. Our income tax rates vary by jurisdiction (country and/or state), and relative changes in the geographic mix of our pre-tax earnings can result in fluctuations in the effective income tax rate. Generally, the effective tax rate on income derived from our U.S. operations, including the effect of U.S. state income taxes, is lower than the effective tax rate on income derived from our non-U.S. operations, in part due to the deferred tax on our foreign earnings that are not permanently reinvested and an election to not claim a credit with respect to foreign income taxes paid but instead to claim a tax deduction, consistent with the election made by Contran, the parent of our consolidated U.S. federal income tax group.

Our geographic mix of pre-tax earnings and the U.S. deferred tax related to our foreign earnings that are not permanently reinvested without offset by foreign tax credits where available are the primary reasons our effective income tax rate in 2010 and 2011 is higher than the 35% U.S. federal statutory income tax rate. In the first quarter of 2011, we recognized a \$2.1 million provision for deferred income taxes related to the undistributed earnings of our Canadian subsidiary attributable to the \$7.5 million patent litigation settlement gain. See Notes 6 and 9 to the Condensed Consolidated



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Financials Statements. Prior to the first quarter of 2010, we had not recognized a deferred tax liability related to incremental income taxes on the pre-2005 undistributed earnings of our Taiwanese subsidiary, as those earnings were deemed to be permanently reinvested. We are required to reassess the permanent reinvestment conclusion on an ongoing basis to determine if our intentions have changed. In the first quarter of 2010, and based primarily upon changes in our cash management plans, we determined that all of the undistributed earnings of our Taiwanese subsidiary can no longer be considered permanently reinvested in Taiwan. Accordingly, in the first quarter of 2010 we recognized an aggregate \$1.9 million provision for deferred income taxes on the pre-2005 undistributed earnings of our Taiwanese subsidiary. Consequently, all of the undistributed earnings of our non-U.S. operations are now considered to be not permanently reinvested.

**Segment Results**

The key performance indicator for our segments is their operating income.

|   | Three months ended<br>September 30, |                  |          | Nine months ended<br>September 30, |                   |          |
|---|-------------------------------------|------------------|----------|------------------------------------|-------------------|----------|
|   | 2010                                | 2011             | % Change | 2010                               | 2011              | % Change |
| (Dollars in thousands)                            |                                     |                  |          |                                    |                   |          |
| <b>Net sales:</b>                                 |                                     |                  |          |                                    |                   |          |
| Security Products                                 | \$ 17,723                           | \$ <b>18,077</b> | 2%       | \$ 51,740                          | \$ <b>54,261</b>  | 5%       |
| Furniture Components                              | 16,119                              | <b>15,588</b>    | (3%)     | 44,504                             | <b>44,630</b>     |          |
| Marine Components                                 | 1,898                               | <b>2,071</b>     | 9%       | 6,680                              | <b>6,864</b>      | 3%       |
| <b>Total net sales</b>                            | <b>\$ 35,740</b>                    | <b>\$ 35,736</b> |          | <b>\$ 102,924</b>                  | <b>\$ 105,755</b> | 3%       |
| <b>Gross profit:</b>                              |                                     |                  |          |                                    |                   |          |
| Security Products                                 | \$ 5,770                            | \$ <b>5,738</b>  | (1%)     | \$ 16,616                          | \$ <b>17,554</b>  | 6%       |
| Furniture Components                              | 3,753                               | <b>2,552</b>     | (32%)    | 10,136                             | <b>8,479</b>      | (16%)    |
| Marine Components                                 | 175                                 | <b>244</b>       | 39%      | 899                                | <b>1,017</b>      | 13%      |
| <b>Total gross profit</b>                         | <b>\$ 9,698</b>                     | <b>\$ 8,534</b>  | (12%)    | <b>\$ 27,651</b>                   | <b>\$ 27,050</b>  | (2%)     |
| <b>Operating income:</b>                          |                                     |                  |          |                                    |                   |          |
| Security Products                                 | \$ 3,680                            | \$ <b>3,550</b>  | (4%)     | \$ 10,261                          | \$ <b>10,911</b>  | 6%       |
| Furniture Components                              | 1,630                               | <b>711</b>       | (56%)    | 2,715                              | <b>8,351</b>      | 208%     |
| Marine Components                                 | (393)                               | <b>(252)</b>     | 36%      | (840)                              | <b>(664)</b>      | 21%      |
| Corporate operating expense                       | (1,778)                             | <b>(2,530)</b>   | (42%)    | (4,323)                            | <b>(5,221)</b>    | (21%)    |
| <b>Total operating income</b>                     | <b>\$ 3,139</b>                     | <b>\$ 1,479</b>  | (53%)    | <b>\$ 7,813</b>                    | <b>\$ 13,377</b>  | 71%      |
| <b>Gross margin as a percentage of net sales:</b> |                                     |                  |          |                                    |                   |          |
| Security Products                                 | 33%                                 | <b>32%</b>       |          | 32%                                | <b>32%</b>        |          |
| Furniture Components                              | 23%                                 | <b>16%</b>       |          | 23%                                | <b>19%</b>        |          |
| Marine Components                                 | 9%                                  | <b>12%</b>       |          | 13%                                | <b>15%</b>        |          |
| <b>Total gross margin</b>                         | <b>27%</b>                          | <b>24%</b>       |          | <b>27%</b>                         | <b>26%</b>        |          |
| <b>Operating income margin:</b>                   |                                     |                  |          |                                    |                   |          |
| Security Products                                 | 21%                                 | <b>20%</b>       |          | 20%                                | <b>20%</b>        |          |
| Furniture Components                              | 10%                                 | <b>5%</b>        |          | 6%                                 | <b>19%</b>        |          |
| Marine Components                                 | (21%)                               | <b>(12%)</b>     |          | (13%)                              | <b>(10%)</b>      |          |
| <b>Total operating income margin</b>              | <b>9%</b>                           | <b>4%</b>        |          | <b>8%</b>                          | <b>13%</b>        |          |

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*Security Products.* Security Products net sales increased 2% in the third quarter and 5% in the first nine months of 2011 compared to the same periods last year. The increase in sales is primarily due to improved customer order rates across most customers with a slightly greater increase among transportation market customers resulting from improved economic conditions in North America. As a percentage of net sales, gross margin and operating income decreased approximately 1 percentage point for the third quarter of 2011 as compared to the prior year due to the net effects of (i) a decrease of 2 percentage points primarily due to higher raw material costs and (ii) a 1 percentage point increase primarily due to lower depreciation expense resulting from assets that became fully depreciated in 2010.

For the 2011 nine month period compared to the same period in 2010, the gross margin and operating income percentages were comparable as the impact of the items noted above on the third quarter comparisons were mitigated by first and second quarter 2011 margins that were slightly better than the comparable periods in 2010 that resulted from greater leverage of fixed manufacturing costs and selling, general and administrative costs with higher level of sales in each of the 2011 periods.

*Furniture Components.* Furniture Components net sales decreased 3% in the third quarter of 2011 compared to the same period last year, and were comparable in the first nine months of 2011 in relation to the same period in the prior year. The decrease in sales for the third quarter is primarily due to lower ergonomic product sales in 2011 due to several one time customer projects in 2010 that were not repeated or replaced in 2011, partially offset by approximately \$600,000 of sales relating to the ergonomics component products business acquired in the third quarter of 2011. Lower ergonomic sales for the nine month period are offset by higher precision slide sales over the same comparative period.

Gross margin percentage decreased by approximately 7 percentage points for the quarter and by approximately 4 percentage points for the nine month comparative periods. The decrease in gross margin percentage for the third quarter was primarily due to (i) a 4 percentage point impact from negative changes in currency exchange rates, (ii) a 2 percentage point impact of lower ergonomic product sales which have higher margins than slide product sales and (iii) a one percentage point impact of higher steel costs that were recovered through surcharges but which negatively impacted margin percentage. The decrease in gross margin percentage for the nine month period was primarily due to (i) a 3 percentage point impact from negative changes in currency exchange rates and (ii) a 1 percentage point impact of higher steel costs that were recovered through surcharges but which negatively impacted margin percentage as surcharges increased sales with no additional contribution above the steel cost. The impact of the acquired ergonomics component business on gross margin percentage for the third quarter and for the nine-month period of 2011 was not significant.

On a percentage basis, Furniture Components operating income decreased 5 percentage points for the quarter primarily due to the above noted items impacting gross margin. For the nine month comparative period, Furniture Components operating income includes: (i) a patent litigation settlement gain of \$7.5 million recognized in the first quarter of 2011, (ii) patent litigation expenses of \$2.1 million and \$227,000 in 2010 and 2011, respectively, and (iii) facility consolidation costs of approximately \$2.0 million in 2011. Excluding the patent litigation settlement gain, patent litigation expenses and facility consolidation costs, operating income percentage decreased 4 percentage points in the first nine months of 2011 compared to the first nine months of 2010 primarily due to the decrease in gross margin for the comparative period, as noted above. See Notes 9 and 7 to the Condensed Consolidated Financial Statements regarding the litigation settlement gain and the facility consolidation costs in the first quarter of 2011, respectively.

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In July of 2011, we completed an acquisition of an ergonomic component products business for cash consideration of the equivalent of approximately \$4.9 million. The acquisition is intended to expand our Furniture Components ergonomics product line. See Notes 2 and 5 to our Condensed Consolidated Financial Statements.

*Marine Components.* Marine Components net sales increased \$173,000, or 9%, and increased \$184,000, or 3%, the third quarter and nine month periods in 2011 compared to the same period in the prior year, respectively. As a percentage of net sales, gross margin and operating income increased for the third quarter and nine month periods of 2011 compared to the respective 2010 periods primarily due to increased leverage of fixed costs as a result of the higher sales in the third quarter and lower intangible amortization expense due to intangibles that became fully amortized in 2010 and the first six months of 2011.

*Outlook.* Demand for our products increased during the first quarter of 2011 compared to the prior year as conditions in the overall economy improved. However, during the later part of the second quarter and continuing into the third quarter, customer orders were flat which appeared to be consistent with the overall economic activity in North America during the that period. It is uncertain whether sales growth will return over the next several months. While changes in market demand are not within our control, we are focused on the areas we can impact. Staffing levels are continuously evaluated in relation to sales order rates which may result in headcount adjustments, to the extent possible, to match staffing levels with demand. We expect our continuous lean manufacturing and cost improvement initiatives, such as the consolidation of our Furniture Components facilities, to positively impact our productivity and result in a more efficient infrastructure. Additionally, we continue to seek opportunities to gain market share in markets we currently serve, expand into new markets and develop new product features in order to mitigate the impact of changes in demand as well as broaden our sales base.

Volatility in the costs of commodity raw materials is ongoing. Our primary commodity raw materials are steel, brass, alloyed zinc and stainless steel which together represent approximately 17% of our total cost of goods sold. Compared to the first nine months of 2010, our cost of these raw materials increased in 2011 between approximately 14% and 24%. We generally seek to mitigate the impact of fluctuations in commodity raw material costs on our margins through improvements in production efficiencies or other operating cost reductions as well as occasionally executing larger quantity tactical spot buys of these raw materials, which may result in higher inventory balances for a period of time. In the event we are unable to offset commodity raw material cost increases with other cost reductions, it may be difficult to recover those cost increases through increased product selling prices or surcharges due to the competitive nature of the markets served by our products. Additionally, significant surcharges may negatively affect our margins as they typically only recover the increased cost of the raw material without adding margin dollars resulting in a lower margin percentage. Consequently, overall operating margins may be affected by commodity raw material cost pressures as is currently the case.

As discussed in Note 9 to the Condensed Consolidated Financial Statements, we have been involved in certain patent infringement litigation, which has in the past resulted in our incurring significant litigation expense. With the settlement reached during the first quarter of 2011, we do not expect to incur significant litigation expense relating to these patent infringement claims going forward.

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The U.S. dollar weakened in 2011 in comparison to the Canadian dollar and the New Taiwan dollar, which are the primary currencies of our non-US operations. At the end of the third quarter the U.S. dollar significantly strengthened although we expect this to be temporary and expect the U.S. dollar will weaken during the fourth quarter and remain below rates that were in effect in 2010, which will likely have a negative impact on our 2011 results in comparison to 2010. When practical, we will seek to mitigate the negative impact of changes in currency exchange rates on our results by entering into currency hedging contracts. However, such strategies cannot fully mitigate the negative impact of changes in currency exchange rates.

**Liquidity and Capital Resources****Consolidated cash flows**

*Operating activities.* Trends in cash flows from operating activities, excluding changes in assets and liabilities have generally been similar to the trends in operating earnings. Changes in assets and liabilities result primarily from the timing of production, sales and purchases. Changes in assets and liabilities generally tend to even out over time. However, period-to-period relative changes in assets and liabilities can significantly affect the comparability of cash flows from operating activities. Our cash provided by operating activities for the first nine months of 2011 increased by \$2.5 million as compared to the first nine months of 2010 primarily due to the net effects of:

Higher operating income in the first nine months of 2011 of \$5.6 million (primarily as a result of a \$7.5 million litigation settlement gain recognized in the first quarter of 2011, partially offset by \$2.0 million in facility consolidation costs);

Higher cash paid for income taxes in the first nine months of 2011 of approximately \$4.9 million due to the timing of tax payments and refunds; and

Higher cash paid for interest of \$1.2 million in 2011 due to timing of interest payments discussed in Note 5 to the Condensed Consolidated Financial Statements.

Relative changes in working capital can have a significant effect on cash flows from operating activities. As shown below, the change in our average days sales outstanding from December 31, 2010 to September 30, 2011 varied by segment. For comparative purposes, we have provided December 31, 2009 and September 30, 2010 numbers below. Overall, our September 30, 2011 days sales outstanding compared to December 31, 2010 is in line with our expectations.

|                                | December 31,<br>2009 | September 30,<br>2010 | December 31,<br>2010 | September 30,<br>2011 |
|--------------------------------|----------------------|-----------------------|----------------------|-----------------------|
| <b>Days Sales Outstanding:</b> |                      |                       |                      |                       |
| Security Products              | 34 Days              | 42 Days               | 40 Days              | 39 Days               |
| Furniture Components           | 40 Days              | 50 Days               | 44 Days              | 47 Days               |
| Marine Components              | 33 Days              | 29 Days               | 34 Days              | 34 Days               |
| Consolidated CompX             | 37 Days              | 45 Days               | 41 Days              | 42 Days               |

As shown below, our consolidated average number of days in inventory decreased from December 31, 2010 to September 30, 2011. For comparative purposes, we have provided December 31, 2009 and September 30, 2010 numbers below. The days in inventory at September 30, 2011 improved slightly from December 31, 2010 due to targeted inventory reduction initiatives. The variability in days in inventory among our segments primarily relates to the differences in the complexity of the production processes and therefore the length of time it takes to produce end-products.

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| <b>Days in Inventory:</b> | <b>December 31,<br/>2009</b> | <b>September 30,<br/>2010</b> | <b>December 31,<br/>2010</b> | <b>September 30,<br/>2011</b> |
|---------------------------|------------------------------|-------------------------------|------------------------------|-------------------------------|
| Security Products         | 77 Days                      | 68 Days                       | 73 Days                      | 72 Days                       |
| Furniture Components      | 44 Days                      | 50 Days                       | 58 Days                      | 56 Days                       |
| Marine Components         | 109 Days                     | 119 Days                      | 143 Days                     | 110 Days                      |
| Consolidated CompX        | 64 Days                      | 63 Days                       | 70 Days                      | 67 Days                       |

*Investing activities.* Net cash used in investing activities totaled \$6.5 million in the first nine months of 2011 compared to net cash used of \$16.5 million in the first nine months of 2010.

During 2011:

we had \$1.8 in capital expenditures, and  
we acquired an ergonomic component products business for \$4.9 million.

During 2010:

we had \$1.5 million in capital expenditures, and  
we purchased a promissory note receivable for \$15.0 million.

*Financing activities.* Net cash used by financing activities was \$6.9 million in the first nine months of 2011 compared to net cash provided of \$332,000 in the first nine months of 2010.

During 2011:

we repaid \$3.0 million that was outstanding under our credit facility at December 31, 2010,

we borrowed \$5.3 million in connection with our acquisition of an ergonomic products business,

we repaid \$4.8 million in principal payments on our promissory note payable to affiliate, and  
we paid \$4.6 million, or \$.375 per share, in dividends.

During 2010:

we borrowed \$5.0 million under our credit facility, and  
we paid \$4.6 million, or \$.375 per share, in dividends.

See Note 5 to the Condensed Consolidated Financial Statements.

*Debt obligations.* At September 30, 2011, there was approximately \$4.8 million outstanding under our \$37.5 million revolving credit facility that matures in January 2012. In the third quarter of 2011, we borrowed \$5.3 million under the credit facility in connection with the acquisition discussed in Notes 2 and 5 to our Condensed Consolidated Financial Statements. At September 30, 2011 we could borrow the full amount of the remaining capacity of our credit facility without violating any debt covenants. We were in compliance with all of our financial covenants at September 30, 2011. Our credit facility expires in January 2012. We expect to renew the credit facility prior to its expiration.

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At September 30, 2011, the outstanding balance of our promissory note payable to affiliate was \$37.5 million. In October 2011, we collected the \$15.0 million principal amount due to us under our promissory note receivable, and subsequently made a \$15.0 million prepayment on the promissory note payable to affiliate. See Note 5 to the Condensed Consolidated Financial Statements.

Provisions contained in our revolving credit facility could result in the acceleration of any outstanding indebtedness prior to its stated maturity for reasons other than defaults from failing to comply with typical financial covenants. For example, our revolving credit facility allows the lender to accelerate the maturity of the indebtedness upon a change of control (as defined) of the borrower. The terms of our revolving credit facility could result in the acceleration of all or a portion of the indebtedness following a sale of assets outside of the ordinary course of business. Other than noted above, there are no current expectations to borrow on the revolving credit facility to fund working capital, capital expenditures, debt service or dividends (if declared), lower future operating results could reduce or eliminate our amount available to borrow and restrict future dividends.

### ***Future cash requirements***

*Liquidity.* Our primary source of liquidity on an on-going basis is our cash flow from operating activities, which is generally used to (i) fund capital expenditures, (ii) repay short-term or long-term indebtedness incurred primarily for capital expenditures, investment activities or reducing our outstanding stock and (iii) provide for the payment of dividends (if declared). From time-to-time, we will incur indebtedness, primarily to fund capital expenditures or business combinations. In addition, from time-to-time, we may also sell assets outside the ordinary course of business, the proceeds of which are generally used to repay indebtedness (including indebtedness which may have been collateralized by the assets sold) or to fund capital expenditures or business combinations.

Periodically, we evaluate liquidity requirements, alternative uses of capital, capital needs and available resources in view of, among other things, our capital expenditure requirements, dividend policy and estimated future operating cash flows. As a result of this process, we have in the past and may in the future seek to raise additional capital, refinance or restructure indebtedness, issue additional securities, modify our dividend policy or take a combination of such steps to manage our liquidity and capital resources. In the normal course of business, we may review opportunities for acquisitions, joint ventures or other business combinations in the component products industry. In the event of any such transaction, we may consider using available cash, issuing additional equity securities or increasing our indebtedness or that of our subsidiaries.

We believe that cash generated from operations together with cash on hand, as well as, our ability to obtain additional external financing, will be sufficient to meet our liquidity needs for working capital, capital expenditures, debt service and dividends (if declared) for both the next twelve months and five years. To the extent that our actual operating results or other developments differ from our expectations, our liquidity could be adversely affected.

Of the \$8.5 million aggregate cash and cash equivalents at September 30, 2011, \$4.3 million was held by our non-U.S. subsidiaries.

*Capital Expenditures.* Firm purchase commitments for capital projects in process at September 30, 2011 totaled \$1.5 million. Our 2011 capital investments are limited to those expenditures required to meet our expected customer demand and those required to properly maintain our facilities.

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*Commitments and Contingencies.* See Note 9 to the Condensed Consolidated Financial Statements for a description of certain legal proceedings.

***Off-balance sheet financing arrangements***

We do not have any off-balance sheet financing agreements other than the operating leases discussed in our 2010 Annual Report.

***Recent accounting pronouncements***

See Note 10 to our Condensed Consolidated Financial Statements.

***Critical accounting policies***

There have been no changes in the first nine months of 2011 with respect to our critical accounting policies presented in Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2010 Annual Report.

***Forward-looking information***

As provided by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, we caution that the statements in this Quarterly Report on Form 10-Q relating to matters that are not historical facts are forward-looking statements that represent our beliefs and assumptions based on currently available information. Forward-looking statements can be identified by the use of words such as "believes," "intends," "may," "should," "anticipates," "expects" or comparable terminology, or by discussions of strategies or trends. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we do not know if our expectations will prove to be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results, and actual future results could differ materially from those described in such forward-looking statements. Among the factors that could cause actual future results to differ materially are the risks and uncertainties discussed in this Quarterly Report and those described from time to time in our other filings with the Securities and Exchange Commission. While it is not possible to identify all factors, we continue to face many risks and uncertainties including, but not limited to the following:

Future demand for our products,

Changes in our raw material and other operating costs (such as steel and energy costs) and our ability to pass those costs on to our customers or offset them with reductions in other operating costs,

Demand for office furniture,

Price and product competition from low-cost manufacturing sources (such as China),

The impact of pricing and production decisions,

Customer and competitor strategies including substitute products,

Uncertainties associated with the development of new product features,

Fluctuations in the value of the U.S. dollar relative to other currencies (such as the Canadian dollar and New Taiwan dollar),

Current and future litigation,

Potential difficulties in integrating completed or future acquisitions,

Decisions to sell operating assets other than in the ordinary course of business,

Environmental matters (such as those requiring emission and discharge standards for existing and new facilities),



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Our ability to comply with covenants contained in our revolving bank credit facility,

The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters,

The impact of current or future government regulations,

General global economic and political conditions (such as changes in the level of gross domestic product in various regions of the world),

Operating interruptions (including, but not limited to labor disputes, hazardous chemical leaks, natural disasters, fires, explosions, unscheduled or unplanned downtime and transportation interruptions); and

Possible disruption of our business or increases in the cost of doing business resulting from terrorist activities or global conflicts. Should one or more of these risks materialize or if the consequences worsen, or if the underlying assumptions prove incorrect, actual results could differ materially from those currently forecasted or expected. We disclaim any intention or obligation to update or revise any forward-looking statement whether as a result of changes in information, future events or otherwise.

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

We are exposed to market risk, including foreign currency exchange rates, interest rates and security prices. For a discussion of these market risk items, refer to Part I, Item 7A Quantitative and Qualitative Disclosure About Market Risk in our 2010 Annual Report, and to Note 8 to the Condensed Consolidated Financial Statements.

We have substantial operations located outside the United States for which the functional currency is not the U.S. dollar. As a result, the reported amounts of our assets and liabilities related to our non-U.S. operations, and therefore our consolidated net assets, will fluctuate based upon changes in currency exchange rates.

**ITEM 4. CONTROLS AND PROCEDURES.**

**Evaluation of Disclosure Controls and Procedures.** We maintain a system of disclosure controls and procedures. The term disclosure controls and procedures, as defined by regulations of the SEC, means controls and other procedures that are designed to ensure that information required to be disclosed in the reports that we file or submit to the SEC under the Securities Exchange Act of 1934, as amended (the Act), is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information we are required to disclose in the reports that we file or submit to the SEC under the Act is accumulated and communicated to our management, including our principal executive officer and our principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions to be made regarding required disclosure. Each of David A. Bowers, our Vice Chairman of the Board, President and Chief Executive Officer, and Darryl R. Halbert, our Vice President, Chief Financial Officer and Controller, have evaluated the design and operating effectiveness of our disclosure controls and procedures as of September 30, 2011. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of the date of such evaluation.

**Internal Control Over Financial Reporting.** We also maintain internal control over financial reporting. The term internal control over financial reporting, as defined by regulations of the SEC, means a process designed by, or under the supervision of, our principal executive and principal financial officers, or persons performing similar functions, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP, and includes those policies and procedures that:



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pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets,

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors, and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our Condensed Consolidated Financial Statements.

**Changes in Internal Control Over Financial Reporting.** There has been no change to our internal control over financial reporting during the quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Part II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings.**

Refer to Note 9 of the Condensed Consolidated Financial Statements and to our 2010 Annual Report for descriptions of certain legal proceedings.

**ITEM 1A. Risk Factors.**

Reference is made to the 2010 Annual Report for a discussion of the risk factors related to our businesses. There have been no material changes in such risk factors during the first nine months of 2011.

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**Table of Contents****ITEM 6. Exhibits.**

| <b>Item No.</b> | <b>Exhibit Index</b>                          |
|-----------------|---|
| 31.1*           | Certification                                 |
| 31.2*           | Certification                                 |
| 32.1*           | Certification                                 |
| 101.INS*        | XBRL Instance Document                        |
| 101.SCH*        | XBRL Taxonomy Extension Schema                |
| 101.CAL*        | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF*        | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB*        | XBRL Taxonomy Extension Label Linkbase        |
| 101.PRE*        | XBRL Taxonomy Extension Presentation Linkbase |

\* Filed herewith.

We have retained a signed original of any of the above exhibits that contains signatures, and we will provide such exhibit to the Commission or its staff upon request. We will also furnish, without charge, a copy of our Code of Business Conduct and Ethics, and Audit Committee Charter, each as adopted by our board of directors on February 24, 2004 and May 28, 2008 respectively, upon request. Such requests should be directed to the attention of our Corporate Secretary at our corporate offices located at 5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**COMPX INTERNATIONAL INC.  
(Registrant)**

Date: November 2, 2011

By: /s/ Darryl R. Halbert  
Darryl R. Halbert  
Vice President, Chief Financial Officer and Controller