

COMPX INTERNATIONAL INC
Form 10-K
February 27, 2019

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

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.) |
|---|--|

5430 LBJ Freeway, Suite 1700,

| | |
|---|--------------------------|
| Three Lincoln Centre, Dallas, Texas (Address of principal executive offices) | 75240-2620 (Zip Code) |
|---|--------------------------|

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

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

Name of each exchange

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Class A common stock on which registered
NYSE American

(\$0.01 par value per share)

Securities registered pursuant to Section 12(g) of the Act: None.

Indicate by check mark:

If the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registration was required to submit such files). Yes No

If disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No

Whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | |
|-------------------------|---------------------------|
| Large accelerated filer | Accelerated filer |
| Non-accelerated filer | Smaller reporting company |
| Emerging growth company | |

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

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

The aggregate market value of the 1.7 million shares of voting stock held by nonaffiliates of CompX International Inc. as of June 30, 2018 (the last business day of the Registrant's most recently completed second fiscal quarter) approximated \$22.0 million.

As of February 21, 2019, 12,435,557 shares of Class A common stock were outstanding.

Documents incorporated by reference

The information required by Part III is incorporated by reference from the Registrant's definitive proxy statement to be filed with the Commission pursuant to Regulation 14A not later than 120 days after the end of the fiscal year covered

by this report.



PART I

ITEM 1. BUSINESS

General

CompX International Inc. (NYSE American: CIX), incorporated in Delaware in 1993, is a leading manufacturer of security products used in the recreational transportation, postal, office and institutional furniture, cabinetry, tool storage, healthcare and a variety of other industries. We are also a leading manufacturer of stainless steel exhaust systems, gauges, throttle controls, wake enhancement systems and trim tabs for the recreational marine industry. Our products are principally designed for use in medium to high-end product applications where design, quality and durability are valued by our customers.

At December 31, 2018, (i) NL Industries, Inc. (NYSE: NL) owns 87% of our outstanding common stock, Valhi, Inc. (NYSE: VHI) owns 83% of NL's outstanding common stock and a subsidiary of Contran Corporation owns 92% of Valhi's outstanding common stock. As discussed in Note 1 to our Consolidated Financial Statements, Lisa K. Simmons and Serena Simmons Connelly may be deemed to control Contran, Valhi, NL and us.

Our corporate offices are located at Three Lincoln Centre, 5430 LBJ Freeway, Suite 1700, Dallas, Texas 75240. Our telephone number is (972) 448-1400. We maintain a website at www.compx.com.

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

Forward-Looking Statements

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Annual Report that are not historical facts are forward-looking in nature and represent management's beliefs and assumptions based on currently available information. In some cases, you can identify forward-looking statements by the use of words such as "believes," "intends," "may," "should," "could," "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 these expectations will be correct. Such statements by their nature involve substantial risks and uncertainties that could significantly impact expected results. Actual future results could differ materially from those predicted. The factors that could cause actual future results to differ materially from those described herein are the risks and uncertainties discussed in this Annual Report and those described from time to time in our other filings with the U.S. Securities and Exchange Commission (the "SEC") and include, but are not limited to, the following:

• Future demand for our products,

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

• 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 products and product features,

• Future litigation,

• Our ability to protect or defend our intellectual property rights,

• Potential difficulties in integrating 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),
The ultimate outcome of income tax audits, tax settlement initiatives or other tax matters, including future tax reform,
The impact of current or future government regulations (including employee healthcare benefit related regulations),
General global economic and political conditions that introduce instability into the U.S. economy (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, transportation interruptions and cyber attacks); 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.

Industry Overview

We manufacture engineered components utilized in a variety of applications and industries. We manufacture mechanical and electrical cabinet locks and other locking mechanisms used in recreational transportation, postal, office and institutional furniture, cabinetry, tool storage and healthcare applications. We also manufacture stainless steel exhaust systems, gauges, throttle controls, wake enhancement systems and trim tabs for the recreational marine and other industries. We continuously seek to diversify into new markets and identify new applications and features for our products, which we believe provide a greater potential for higher rates of earnings growth as well as diversification of risk. See also Item 6 – “Selected Financial Data” and Item 7 – “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

Business Segments

We currently have two operating business segments – Security Products and Marine Components. For additional information regarding our segments, see “Part II – Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Note 2 to the Consolidated Financial Statements.

Manufacturing, Operations and Products

Security Products. Our Security Products segment manufactures mechanical and electrical cabinet locks and other locking mechanisms used in a variety of applications including ignition systems, mailboxes, file cabinets, desk drawers, tool storage cabinets, vending and cash containment machines, high security medical cabinetry, electronic circuit panels, storage compartments and gas station security. Our Security Products segment has one manufacturing facility in Mauldin, South Carolina and one in Grayslake, Illinois which is shared with Marine Components. We believe we are a North American market leader in the manufacture and sale of cabinet locks and other locking mechanisms. These products include:

- disc tumbler locks which provide moderate security and generally represent the lowest cost lock to produce;
- pin tumbler locking mechanisms which are more costly to produce and are used in applications requiring higher levels of security, including KeSet® and System 64® (which each allow the user to change the keying on a single lock 64 times without removing the lock from its enclosure), TuBar® and Turbine™; and

our innovative CompX eLock® and StealthLock® electronic locks which provide stand-alone or networked security and audit trail capability for drug storage and other valuables through the use of a proximity card, magnetic stripe, radio frequency or other keypad credential.

A substantial portion of our Security Products' sales consist of products with specialized adaptations to an individual customer's specifications, some of which are listed above. We also have a standardized product line suitable for many customers, which is offered through a North American distribution network to locksmith and smaller original equipment manufacturer distributors via our STOCK LOCKS® distribution program.

Marine Components. Our Marine Components segment manufactures and distributes stainless steel exhaust components, gauges, throttle controls, wake enhancement systems, trim tabs and related hardware and accessories primarily for performance and ski/wakeboard boats. Our Marine Components segment has a facility in Neenah, Wisconsin and a facility in Grayslake, Illinois which is shared with Security Products. Our specialty Marine Component products are high precision components designed to operate within tight tolerances in the highly demanding marine environment. These products include:

- original equipment and aftermarket stainless steel exhaust headers, exhaust pipes, mufflers and other exhaust components;
- high performance gauges such as GPS speedometers and tachometers;
- mechanical and electronic controls and throttles;
- wake enhancement devices, trim tabs, steering wheels, and billet aluminum accessories; and
- dash panels, LED indicators, wire harnesses and other accessories.

For information regarding our three manufacturing and other facilities, see "Item 2 – Properties," including information regarding leased and distribution-only facilities.

Raw Materials

Our primary raw materials are:

- Security Products - zinc and brass (for the manufacture of locking mechanisms).
- Marine Components - stainless steel (for the manufacture of exhaust headers and pipes and wake enhancement systems), aluminum (for the manufacture of throttles and trim tabs) and other components.

These raw materials are purchased from several suppliers, are readily available from numerous sources and accounted for approximately 12% of our total cost of sales for 2018. Total material costs, including purchased components, represented approximately 45% of our cost of sales in 2018.

We occasionally enter into short-term commodity-related raw material supply arrangements to mitigate the impact of future price increases in commodity-related raw materials, including zinc, brass and stainless steel. These arrangements generally provide for stated unit prices based upon specified purchase volumes, which help us to stabilize our commodity-related raw material costs to a certain extent. During 2017 and 2018, markets for the primary commodity-related raw materials used in the manufacture of our locking mechanisms, primarily zinc and brass, generally strengthened, but were moderating at the end of 2018. Over that same period, the market for stainless steel, the primary raw material used for the manufacture of marine exhaust headers and pipes and wake enhancement systems, remained relatively stable. While we expect the markets for our primary commodity-related raw materials to remain stable during 2019, we recognize that economic conditions could introduce renewed volatility on these and other manufacturing materials. When purchased on the spot market, each of these raw materials may be subject to sudden and unanticipated price increases. When possible, we seek to mitigate the impact of fluctuations in these raw material costs on our margins through improvements in production efficiencies or other operating cost reductions. In the event we are unable to offset raw material cost increases with other cost reductions, it may be difficult to recover those cost increases through increased product selling prices or raw material surcharges due to the competitive nature

of the markets served by our products. Consequently, overall

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operating margins can be affected by commodity-related raw material cost pressures. Commodity market prices are cyclical, reflecting overall economic trends, specific developments in consuming industries and speculative investor activities.

Patents and Trademarks

We hold a number of patents relating to our component products, certain of which we believe to be important to us and our continuing business activity. Patents generally have a term of 20 years, and our patents have remaining terms ranging from 1 year to 16 years at December 31, 2018.

Our major trademarks and brand names in addition to CompX® include:

| | | |
|--|--------------------------------|---------------------------------------|
| Security Products CompX® Security Products™ | Security Products Lockview® | Marine Components CompX Marine® |
| National Cabinet Lock® | System 64® | Custom Marine® |
| Fort Lock® | SlamCAM® | Livorsi® Marine |
| Timberline® Lock | RegulatoR® | Livorsi II® Marine |
| Chicago Lock® | CompXpress® | CMI Industrial® |
| STOCK LOCKS® | GEM® | Custom Marine® Stainless Exhaust |
| KeSet® | | The #1 Choice in Performance Boating® |
| TuBar® | | Mega Rim® |
| StealthLock® | | Race Rim® |
| ACE® | | Vantage View® |
| ACE® II | | GEN-X® |

CompX eLock®

Sales, Marketing and Distribution

A majority of our component sales are direct to large OEM customers through our factory-based sales and marketing professionals supported by engineers working in concert with field salespeople and independent manufacturer's representatives. We select manufacturer's representatives based on special skills in certain markets or relationships with current or potential customers.

In addition to sales to large OEM customers, a substantial portion of our Security Products sales are made through distributors. We have a significant North American market share of cabinet lock security product sales as a result of the locksmith distribution channel. We support our locksmith distributor sales with a line of standardized products used by the largest segments of the marketplace. These products are packaged and merchandised for easy availability and handling by distributors and end users.

We sell to a diverse customer base with only one customer representing 10% or more of our sales in 2018 (United States Postal Service representing 13%). Our largest ten customers accounted for approximately 44% of our sales in 2018.

Competition

The markets in which we participate are highly competitive. We compete primarily on the basis of product design, including space utilization and aesthetic factors, product quality and durability, price, on-time delivery, service and technical support. We focus our efforts on the middle and high-end segments of the market, where product design, quality, durability and service are valued by the customer. Our Security Products segment competes against a number of domestic and foreign manufacturers. Our Marine Components segment competes with small domestic manufacturers and is minimally affected by foreign competitors.

Regulatory and Environmental Matters

Our operations are subject to federal, state and local laws and regulations relating to the use, storage, handling, generation, transportation, treatment, emission, discharge, disposal, remediation of and exposure to hazardous and non-hazardous substances, materials and wastes (“Environmental Laws”). Our operations also are subject to federal, state and local laws and regulations relating to worker health and safety. We believe we are in substantial compliance with all such laws and regulations. To date, the costs of maintaining compliance with such laws and regulations have not significantly impacted our results. We currently do not anticipate any significant costs or expenses relating to such matters; however, it is possible future laws and regulations may require us to incur significant additional expenditures.

Employees

As of December 31, 2018, we employed 547 people, all in the United States. We believe our labor relations are good at all of our facilities.

Website and Available Information

Our fiscal year end is always the Sunday closest to December 31, and our operations are reported on a 52 or 53-week fiscal year. For presentation purposes, annual and quarterly information in this Form 10-K are presented as ended on March 31, June 30, September 30, and December 31, as applicable. The actual date of our fiscal years ended December 31, 2016, 2017 and 2018 are January 1, 2017, December 31, 2017, and December 30, 2018, respectively. We furnish our stockholders with annual reports containing audited financial statements. In addition, we file annual, quarterly and current reports; proxy and information statements and other information with the SEC. We also make our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all related amendments, available free of charge through our website at www.compx.com as soon as reasonably practical after they have been filed with the SEC. We also provide to anyone, without charge, copies of the documents upon written request. Requests should be directed to the attention of the Corporate Secretary at our address on the cover page of this Form 10-K.

Additional information, including our Audit Committee Charter, our Code of Business Conduct and Ethics and our Corporate Governance Guidelines, can also be found on our website. Information contained on our website is not a part of this Annual Report.

We are an electronic filer. The SEC maintains an internet website at www.sec.gov that contains reports, proxy and information statements and other information regarding issuers, such as us, that file electronically with the SEC.

ITEM 1A. RISK FACTORS

Listed below are certain risk factors associated with us and our businesses. In addition to the potential effect of these risk factors discussed below, any risk factor which could result in reduced earnings or operating losses, or reduced liquidity, could in turn adversely affect our ability to service our liabilities or pay dividends on our common stock or adversely affect the quoted market prices for our securities.

We operate in mature and highly competitive markets, resulting in pricing pressure and the need to continuously reduce costs.

Many of the markets we serve are highly competitive, with a number of competitors offering similar products. We focus our efforts on the middle and high-end segment of the market where we feel that we can compete due to the importance of product design, quality and durability to the customer. However, our ability to effectively compete is

impacted by a number of factors. The occurrence of any of these factors could result in reduced earnings or operating losses.

- Competitors may be able to drive down prices for our products beyond our ability to adjust costs because their costs are lower than ours, especially products sourced from Asia.

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• Competitors' financial, technological and other resources may be greater than our resources, which may enable them to more effectively withstand changes in market conditions.

• Competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements.

• Consolidation of our competitors or customers in any of the markets in which we compete may result in reduced demand for our products.

• A reduction of our market share with one or more of our key customers, or a reduction in one or more of our key customers' market share for their end-use products, may reduce demand for our products.

• New competitors could emerge by modifying their existing production facilities to manufacture products that compete with our products.

• We may not be able to sustain a cost structure that enables us to be competitive.

• Customers may no longer value our product design, quality or durability over the lower cost products of our competitors.

Our development of innovative features for current products is critical to sustaining and growing our sales.

Historically, our ability to provide value-added custom engineered products that address requirements of technology and space utilization has been a key element of our success. We spend a significant amount of time and effort to refine, improve and adapt our existing products for new customers and applications. Since expenditures for these types of activities are not considered research and development expense under accounting principles generally accepted in the United States of America ("GAAP"), the amount of our research and development expenditures, which is not significant, is not indicative of the overall effort involved in the development of new product features. The introduction of new product features requires the coordination of the design, manufacturing and marketing of the new product features with current and potential customers. The ability to coordinate these activities with current and potential customers may be affected by factors beyond our control. While we will continue to emphasize the introduction of innovative new product features that target customer-specific opportunities, we do not know if any new product features we introduce will achieve the same degree of success that we have achieved with our existing products. Introduction of new product features typically requires us to increase production volume on a timely basis while maintaining product quality. Manufacturers often encounter difficulties in increasing production volumes, including delays, quality control problems and shortages of qualified personnel or raw materials. As we attempt to introduce new product features in the future, we do not know if we will be able to increase production volumes without encountering these or other problems, which might negatively impact our financial condition or results of operations.

Higher costs of our commodity-related raw materials may decrease our liquidity.

Certain raw materials used in our products are commodities that are subject to significant fluctuations in price in response to world-wide supply and demand as well as speculative investor activity. Zinc and brass are the principal raw materials used in the manufacture of security products. Stainless steel and aluminum are the major raw materials used in the manufacture of marine components. These raw materials are purchased from several suppliers and are generally readily available from numerous sources. We occasionally enter into short-term raw material supply arrangements to mitigate the impact of future increases in commodity-related raw material costs. Materials purchased outside of these arrangements are sometimes subject to unanticipated and sudden price increases. Should our vendors not be able to meet their contractual obligations or should we be otherwise unable to obtain necessary raw materials, we may incur higher costs for raw materials or may be required to reduce production levels, either of which may decrease our liquidity or negatively impact our financial condition or results of operations as we may be unable to offset the higher costs with increases in our selling prices or reductions in other operating costs.

Failure to protect our intellectual property rights or claims by others that we infringe their intellectual property rights could substantially harm our business.

We rely on patent, trademark and trade secret laws in the United States and similar laws in other countries to establish and maintain our intellectual property rights in our technology and designs. Despite these measures, any of our intellectual property rights could be challenged, invalidated, circumvented or misappropriated. Others may independently discover our trade secrets and proprietary information, and in such cases we could not assert any trade secret rights against such parties. Further, we do not know if any of our pending trademark or patent applications will be approved. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our intellectual property rights. In addition, the laws of certain countries do not protect intellectual property rights to the same extent as the laws of the United States. Therefore, in certain jurisdictions, we may be unable to protect our technology and designs adequately against unauthorized third party use, which could adversely affect our competitive position.

Third parties may claim that we or our customers are infringing upon their intellectual property rights. Even if we believe that such claims are without merit, they can be time-consuming and costly to defend and distract our management's and technical staff's attention and resources. Claims of intellectual property infringement also might require us to redesign affected technology, enter into costly settlement or license agreements or pay costly damage awards, or face a temporary or permanent injunction prohibiting us from marketing or selling certain of our technology. If we cannot or do not license the infringed technology on reasonable pricing terms or at all, or substitute similar technology from another source, our business could be adversely impacted.

Global climate change legislation could negatively impact our financial results or limit our ability to operate our businesses.

All of our production facilities are located in the United States and we believe all of our production facilities are in substantial compliance with applicable environmental laws. To date, legislation and regulatory actions related to climate change have not had a material adverse effect on our financial results. However, if new legislation or regulatory actions related to climate change were to be enacted or implemented, it could negatively impact our future results from operations through increased costs of production, particularly as it relates to our energy requirements. If such increased costs of production were to materialize, we may be unable to pass price increases on to our customers to compensate for increased production costs, which may decrease our liquidity, operating income and results of operations.

Technology failures or cyber security breaches could have a material adverse effect on our operations.

We rely on information technology systems to manage, process and analyze data, as well as to facilitate the manufacture and distribution of our products to and from our plants. We receive, process and ship orders, manage the billing of and collections from our customers, and manage the accounting for and payment to our vendors. Although we have systems and procedures in place to protect our information technology systems, there can be no assurance that such systems and procedures would be sufficiently effective. Therefore, any of our information technology systems may be susceptible to outages, disruptions, or destruction as well as cyber security breaches or attacks, resulting in a disruption of our business operations, injury to people, harm to the environment or our assets, and/or the inability to access our information technology systems. If any of these events were to occur, our results of operations and financial condition could be adversely affected.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive offices are located in leased space at 5430 LBJ Freeway, Dallas, Texas 75240. The following table sets forth the location, size and business operating segment for each of our operating facilities.

| Facility Name | Business Segment | Location | Size (square feet) |
|--------------------------|------------------|---------------|--------------------|
| Owned Facilities: | | | |
| National ⁽¹⁾ | SP | Mauldin, SC | 198,000 |
| Grayslake ⁽¹⁾ | SP/MC | Grayslake, IL | 133,000 |
| Custom ⁽¹⁾ | MC | Neenah, WI | 95,000 |

Leased Facilities:

| | | | |
|---------------------|-------|----------------------|--------|
| Distribution Center | SP/MC | Rancho Cucamonga, CA | 11,500 |
|---------------------|-------|----------------------|--------|

SP – Security Products business segment

MC – Marine Components business segment

⁽¹⁾ ISO-9001 registered facilities

We believe all of our facilities are well maintained and satisfactory for their intended purposes.

ITEM 3. LEGAL PROCEEDINGS

We are involved, from time to time, in various environmental, contractual, product liability, patent (or intellectual property), employment and other claims and disputes incidental to our business. See Note 10 to the Consolidated Financial Statements. We currently believe that the disposition of all claims and disputes, individually or in the aggregate, should not have a material adverse effect on our consolidated financial condition, results of operations or liquidity.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS
 Common Stock and Dividends. Our Class A common stock is listed and traded on the NYSE American (symbol: CIX). As of February 21, 2019, there were approximately 16 holders of record of CompX Class A common stock.

Performance Graph. Set forth below is a line graph comparing the yearly change in our cumulative total stockholder returns on our Class A common stock against the cumulative total return of the Russell 2000 Index and an index of a self-selected peer group of companies for the period from December 31, 2013 through December 31, 2018. The peer group index is comprised of The Eastern Company and Strattec Security Corporation. The graph shows the value at December 31 of each year assuming an original investment of \$100 at December 31, 2013 and reinvestment of dividends.

| | December 31, | | | | | |
|--------------------------|--------------|------|------|-------|-------|-------|
| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| CompX International Inc. | \$100 | \$87 | \$84 | \$121 | \$101 | \$105 |
| Russell 2000 Index | 100 | 105 | 100 | 122 | 139 | 124 |
| Peer Group | 100 | 156 | 126 | 110 | 130 | 105 |

Equity compensation plan information. We have a share based incentive compensation plan, approved by our stockholders, pursuant to which an aggregate of 200,000 shares of our common stock can be awarded to non-employee members of our board of directors. At December 31, 2018, 156,550 shares are available for award under this plan. See Note 8 to the Consolidated Financial Statements.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with the Consolidated Financial Statements and Item 7 - "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Our fiscal year end is always the Sunday closest to December 31, and our operations are reported on a 52 or 53-week fiscal year. 2015 was a 53-week year; all other years shown are 52-week years.

| | Years ended December 31, | | | | |
|--|---|---------|---------|---------|---------|
| | 2014 | 2015 | 2016 | 2017 | 2018 |
| | (\$ in millions, except per share data) | | | | |
| Statements of Operations Data: | | | | | |
| Net sales | \$103.8 | \$109.0 | \$108.9 | \$112.0 | \$118.2 |
| Gross profit | 32.2 | 33.4 | 35.2 | 34.8 | 38.3 |
| Operating income | 13.6 | 14.0 | 15.6 | 15.2 | 17.8 |
| Non-operating income – interest income | 0.1 | 0.1 | 0.4 | 1.9 | 2.7 |
| Provision for income taxes | 5.0 | 4.9 | 5.5 | 4.0 | 5.2 |
| Net income | 8.7 | 9.1 | 10.5 | 13.2 | 15.3 |
| Per Share Data: | | | | | |
| Diluted earnings | \$.70 | \$.73 | \$.84 | \$1.06 | \$1.23 |
| Cash dividends | .20 | .20 | .20 | .20 | .20 |
| Weighted average common shares outstanding | 12.4 | 12.4 | 12.4 | 12.4 | 12.4 |
| Balance Sheet Data (at year end): | | | | | |
| Cash and other current assets | \$71.7 | \$76.9 | \$59.2 | \$56.4 | \$76.3 |
| Total assets | 129.1 | 134.8 | 144.0 | 151.0 | 166.4 |
| Current liabilities | 13.2 | 12.1 | 13.3 | 11.3 | 13.7 |
| Stockholders' equity | 111.0 | 117.7 | 125.8 | 136.6 | 149.6 |
| Statements of Cash Flow Data: | | | | | |
| Cash provided by (used in): | | | | | |
| Operating activities | \$12.2 | \$13.5 | \$13.9 | \$12.6 | \$17.2 |
| Investing activities | (2.9) | (4.2) | (30.6) | (13.6) | 1.1 |
| Financing activities | (2.5) | (2.5) | (2.5) | (2.5) | (2.5) |

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Business 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 electrical cabinet locks and other locking mechanisms used in recreational transportation, postal, office and institutional furniture, cabinetry, tool storage and healthcare applications. We also manufacture stainless steel exhaust systems, gauges, throttle controls, wake enhancement systems and trim tabs for the recreational marine and other industries through our Marine Components segment.

Operating Income Overview

We reported operating income of \$17.8 million in 2018 compared to operating income of \$15.2 million in 2017 and \$15.6 million in 2016. The increase in operating income in 2018 over 2017 is primarily due to higher sales at both Security Products and Marine Components. Operating income in 2017 was comparable to operating income in 2016.

Our product offerings consist of a large number of products that have a wide variation in selling price and manufacturing cost, which results in certain practical limitations on our ability to quantify the impact of changes in individual product sales quantities and selling prices on our net sales, cost of goods sold and gross profit. In addition, small variations in period-to-period net sales, cost of goods sold and gross profit can result from changes in the relative mix of our products sold.

Critical Accounting Policies and Estimates

We have based the accompanying "Management's Discussion and Analysis of Financial Condition and Results of Operations" upon our Consolidated Financial Statements. We prepared our Consolidated Financial Statements in accordance with GAAP. In preparing our Consolidated Financial Statements, we are required to make estimates and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reported period. On an on-going basis, we evaluate our estimates, including those related to inventory reserves, the recoverability of long-lived assets (including goodwill and other intangible assets) and the realization of deferred income tax assets. We base our estimates on historical experience and on various other assumptions we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the reported amounts of assets, liabilities, revenues and expenses. Our actual future results might differ from previously estimated amounts under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our Consolidated Financial Statements and are applicable to all of our operating segments:

◆ **Goodwill** – Our goodwill totaled \$23.7 million at December 31, 2018. We perform a goodwill impairment test annually in the third quarter of each year. Goodwill is also evaluated for impairment at other times whenever an event occurs or circumstances change that would more-likely-than-not reduce the fair value of a reporting unit below its carrying value. All of our net consolidated goodwill at December 31, 2018 is related to our Security Products segment. In 2018, we used the qualitative assessment of Accounting Standards Codification ("ASC") 350-20-35, Goodwill, for our annual impairment test and determined it was not necessary to perform the quantitative goodwill impairment test, as we concluded it is more-likely-than-not that the fair value of the Security Products reporting unit exceeded its carrying amount. See Notes 1 and 5 to our Consolidated Financial Statements.

When performing a qualitative assessment considerable management judgment is necessary to evaluate the qualitative impact of events and circumstances on the fair value of a reporting unit. Events and circumstances considered in our impairment evaluations, such as historical profits and stability of the

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markets served, are consistent with factors utilized with our internal projections and operating plan. However, future events and circumstances could result in materially different findings which could result in the recognition of a material goodwill impairment.

Long-lived assets – We assess property and equipment for impairment only when circumstances (as specified in ASC 360-10-35, Property, Plant, and Equipment) indicate an impairment may exist. Our determination is based upon, among other things, our estimates of the amount of future net cash flows to be generated by the long-lived asset (Level 3 inputs) and our estimates of the current fair value of the asset.

Significant judgment is required in estimating such cash flows. Adverse changes in such estimates of future net cash flows or estimates of fair value could result in an inability to recover the carrying value of the long-lived asset, thereby possibly requiring an impairment charge to be recognized in the future. We do not assess our property and equipment for impairment unless certain impairment indicators specified in ASC Topic 360-10-35 are present. We did not evaluate any long-lived assets for impairment during 2018 because no such impairment indicators were present.

Results of Operations - 2018 Compared to 2017 and 2017 Compared to 2016

| | Years ended December 31, | | | %Change | |
|------------------------------|--------------------------|----------|----------|-----------|---------|
| | 2016 | 2017 | 2018 | 2016-2017 | 2017-18 |
| | (Dollars in millions) | | | | |
| Net sales | \$108.9 | \$ 112.0 | \$ 118.2 | 3 % | 6 % |
| Cost of goods sold | 73.7 | 77.2 | 79.9 | 5 | 4 |
| Gross profit | 35.2 | 34.8 | 38.3 | -1 | 10 |
| Operating costs and expenses | 19.6 | 19.6 | 20.5 | - | 4 |
| Operating income | \$ 15.6 | \$ 15.2 | \$ 17.8 | -2 | 17 |
| Percent of net sales: | | | | | |
| Cost of goods sold | 67.7 | % 68.9 | % 67.6 | % | |
| Gross margin | 32.2 | 31.1 | 32.4 | | |
| Operating costs and expenses | 18.0 | 17.5 | 17.3 | | |
| Operating income | 14.3 | 13.6 | 15.1 | | |

Net Sales. Net sales increased approximately \$6.2 million in 2018 compared to 2017 primarily due to higher Marine Components sales volumes to manufacturers of ski/wakeboard boats and larger center-console boats, and to a lesser extent higher Security Products sales to certain markets, particularly transportation and office furniture. Relative changes in selling prices did not have a material impact on net sales comparisons.

Net sales increased approximately \$3.1 million in 2017 compared to 2016 primarily due to higher Security Products sales volumes to government security, electronic lock and other markets, partially offset by a decrease in sales of security products to an original equipment manufacturer of recreational transportation products. Marine Components also contributed with higher sales, primarily to the ski/wakeboard boat market. Relative changes in selling prices did not have a material impact on net sales comparisons.

Cost of Goods Sold and Gross Profit. Cost of goods sold increased from 2017 to 2018 primarily due to increased sales volumes for both the Security Products and Marine Components segments. Gross profit dollars and gross profit as a percentage of sales increased from 2017 to 2018 primarily due to greater fixed cost leverage facilitated by higher production volumes for each of our business segments.

Cost of goods sold increased from 2016 to 2017 primarily due to increased sales volumes for both the Security Products and Marine Components segments, and to a lesser extent higher raw material prices (mostly zinc

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and brass) and increased employee medical costs. Gross profit dollars in 2017 were comparable to 2016. As a percentage of sales, gross profit for 2017 decreased compared to 2016 due primarily to unfavorable relative changes in customer and product mix, higher raw material prices and increased employee medical costs in the Security Products segment, as well as higher manufacturing costs for the Marine Components segment.

Operating Costs and Expenses. Operating costs and expenses consist primarily of sales and administrative-related personnel costs, sales commissions and advertising expenses directly related to product sales and administrative costs relating to business unit and corporate management activities, as well as gains and losses on sales of property, plant and equipment. Operating costs and expenses as a percentage of sales were comparable in 2016, 2017 and 2018.

Operating Income. As a percentage of net sales, operating income increased from 2017 to 2018 while operating income decreased slightly from 2016 to 2017. Operating margins were primarily impacted by the factors impacting cost of goods sold, gross margin and operating costs discussed above.

General. Our profitability primarily depends on our ability to utilize our production capacity effectively, which is affected by, among other things, the demand for our products and our ability to control our manufacturing costs, primarily comprised of labor costs and materials. The materials used in our products consist of purchased components and raw materials some of which are subject to fluctuations in the commodity markets such as zinc, brass and stainless steel. Total material costs represented approximately 45% of our cost of sales in 2018, with commodity-related raw materials accounting for approximately 12% of our cost of sales. During 2017 and 2018, markets for the primary commodity-related raw materials used in the manufacture of our locking mechanisms, primarily zinc and brass, generally strengthened, but were moderating at the end of 2018. Over that same period, the market for stainless steel, the primary raw material used for the manufacture of marine exhaust headers and pipes and wake enhancement systems, remained relatively stable. While we expect the markets for our primary commodity-related raw materials to remain stable during 2019, we recognize that economic conditions could introduce renewed volatility on these and other manufacturing materials.

We occasionally enter into short-term commodity-related raw material supply arrangements to mitigate the impact of future increases in commodity related raw material costs. See Item 1 - "Business- Raw Materials."

Interest Income. Interest income in 2018 increased compared to 2017 primarily due to higher interest rates on our loan to an affiliate (originated late in 2016) as well as our cash investments. Interest income in 2017 increased compared to 2016 due to higher average balances on our loan to an affiliate and to a lesser extent higher interest rates in 2017. See Note 9 to the Consolidated Financial Statements.

Provision for income taxes. A tabular reconciliation of our actual tax provision to the U.S. federal statutory income tax rate is included in Note 7 to the Consolidated Financial Statements. As a member of the group of companies consolidated for U.S. federal income tax purposes with Contran, the parent of our consolidated U.S. federal income tax group, we compute our provision for income taxes on a separate company basis, using the tax elections made by Contran.

Our effective income tax rate was 35% in 2016, 23% in 2017 and 25% in 2018. Our effective income tax rate was lower in 2017 and 2018 as compared to 2016 as a result of tax reform legislation. On December 22, 2017, H.R.1, formally known as the "Tax Cuts and Jobs Act" ("2017 Tax Act") was enacted into law. This tax legislation, among other changes, (i) reduced the U.S Federal corporate income tax rate from 35% to 21% effective January 1, 2018; (ii) eliminated the domestic production activities deduction beginning in 2018; and (iii) allowed the expensing of certain capital expenditures. Following the enactment of the 2017 Tax Act, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) 118 to provide guidance on the accounting and reporting impacts of the 2017 Tax Act. SAB 118 required that companies account for changes related to the 2017 Tax Act in the period of enactment unless the impact of such changes could not be reasonably estimated. Where the use of estimated provisional amounts was necessary, SAB 118 provided for a measurement period of no longer than one year during which companies could

adjust those amounts as additional information became available. Therefore, as required under GAAP, we revalued our net deferred tax liability associated with our net taxable temporary differences based on deferred tax balances as of the enactment date to reflect the effect of the reduction in the corporate income tax rate. Our temporary differences as of December 31, 2017 were not materially different from

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our temporary differences as of the enactment date; accordingly revaluation of our net taxable temporary differences was based on our net deferred tax liability as of December 31, 2017. Such revaluation resulted in a non-cash deferred income tax benefit of \$1.9 million recognized in continuing operations for the period ended December 31, 2017, reducing our net deferred income tax liability as of that date. During 2018 we finalized our analysis of the 2017 Tax Act and recorded an immaterial adjustment within the defined measurement period. See Notes 7 and 10 to our Consolidated Financial Statements.

While our effective income tax rate for 2018 was favorably impacted by the reduction in the U.S. federal statutory income tax rate from 35% to 21%, our effective income tax rate was higher in 2018 as compared to 2017 due to the \$1.9 million non-cash deferred income tax benefit recognized in 2017 resulting from the revaluation of our net deferred income tax liability discussed above. We currently expect our effective income tax rate for 2019 to be comparable to 2018.

Segment Results

The key performance indicator for our segments is the level of their operating income (see discussion below). For additional information regarding our segments refer to Note 2 to our Consolidated Financial Statements.

| | Years ended December 31, | | | % Change | |
|-------------------------------|--------------------------|---------|---------|-------------|-------------|
| | 2016 | 2017 | 2018 | 2016 – 2017 | 2017 – 2018 |
| | (In millions) | | | | |
| Net sales: | | | | | |
| Security Products | \$94.7 | \$96.6 | \$98.4 | 2 % | 2 % |
| Marine Components | 14.2 | 15.4 | 19.8 | 8 | 29 |
| Total net sales | \$108.9 | \$112.0 | \$118.2 | 3 | 6 |
| Gross profit: | | | | | |
| Security Products | \$31.2 | \$31.1 | \$32.9 | - | 6 |
| Marine Components | 4.0 | 3.7 | 5.4 | -7 | 46 |
| Total gross profit | \$35.2 | \$34.8 | \$38.3 | -1 | 10 |
| Operating income: | | | | | |
| Security Products | \$20.0 | \$19.2 | \$22.0 | -4 | 14 |
| Marine Components | 1.7 | 1.3 | 2.7 | -21 | 104 |
| Corporate operating expenses | (6.1) | (5.3) | (6.9) | 13 | -30 |
| Total operating income | \$15.6 | \$15.2 | \$17.8 | -2 | 17 |
| Operating income margin: | | | | | |
| Security Products | 21.1 % | 19.9 % | 22.3 % | | |
| Marine Components | 12.0 | 8.7 | 13.8 | | |
| Total operating income margin | 14.3 | 13.6 | 15.1 | | |

Security Products. Security Products net sales increased 2% to \$98.4 million in 2018 compared to \$96.6 million in 2017, primarily due to higher sales to the transportation and office furniture markets. As a percentage of sales, gross profit for 2018 increased slightly over 2017 due to lower production costs, including headcount reductions made during the second quarter of 2017, and improved coverage of fixed costs over increased production volumes. Operating costs and expenses for 2018 were slightly lower than 2017. As a result, Security Products

operating income as a percentage of net sales for 2018 exceeded 2017.

Security Products net sales increased 2% to \$96.6 million in 2017 compared to \$94.7 million in 2016, as improved sales to government security, electronic lock and other markets more than offset a decrease of approximately \$2.9 million in sales to a customer serving the recreational transportation market. As a percentage of sales, gross profit for 2017 decreased compared to 2016 primarily due to unfavorable relative changes in customer and product mix, and to a lesser extent higher raw material prices (mostly zinc and brass) and increased employee

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medical costs. Operating costs and expenses for 2017 were comparable to 2016. As a result, Security Products operating income as a percentage of net sales for 2017 was below 2016.

Marine Components. Marine Components net sales increased 29% in 2018 as compared to 2017 as a result of continued strong demand for our products, particularly those sold to the ski/wakeboard boat market as well as to manufacturers of large center-console boats and industrial customers. Gross profit margin and operating income as a percentage of net sales increased in 2018 compared to 2017 principally due to improved fixed cost leverage facilitated by higher production volumes.

Marine Components net sales increased 8% in 2017 as compared to 2016 as a result of continued strong demand for our products, particularly those sold to the ski/wakeboard boat market. Gross profit margin and operating income as a percentage of net sales decreased in 2017 compared to 2016 principally due to unfavorable relative changes in customer and product mix and higher manufacturing costs, including the impact of personnel turnover in key manufacturing departments.

Outlook

Our 2018 sales growth was largely attributable to high demand for our marine products, where we continue to benefit from innovation and diversification in our product offerings to the recreational boat markets. We also increased sales of security products, particularly to the transportation and office furniture markets. In 2019, we will seek to maintain the positive momentum in each of our business segments to grow sales and profitability. We will continue to monitor economic conditions and sales order rates and respond to fluctuations in customer demand through continuous evaluation of staffing levels and consistent execution of our lean manufacturing and cost improvement initiatives. Additionally, we continue to seek opportunities to gain market share in markets we currently serve, to expand into new markets and to develop new product features in order to mitigate the impact of changes in demand as well as broaden our sales base.

Liquidity and Capital Resources

Summary

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, business combinations or buying back shares of our outstanding stock and (iii) provide for the payment of dividends (if declared). From time-to-time, we may incur indebtedness to fund capital expenditures, business combinations or other investment activities. 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.

Consolidated cash flows

Operating activities. Trends in cash flows from operating activities, excluding changes in assets and liabilities, for the last three years have generally been similar to the trends in our earnings. Depreciation and amortization was comparable in each of 2018, 2017 and 2016. See Note 1 to our Consolidated Financial Statements.

Changes in assets and liabilities result primarily from the timing of production, sales and purchases. Such changes in assets and liabilities generally tend to even out over time. However, year-to-year relative changes in assets and liabilities can significantly affect the comparability of cash flows from operating activities. Cash provided by operating activities was \$17.2 million in 2018 compared to \$12.6 million in 2017. The \$4.6 million increase in cash provided by operating activities is primarily the net result of:

- \$2.6 million increase in operating income in 2018,
- \$2.3 million decrease in cash paid for taxes in 2018 as the favorable impact of the lower U.S. federal corporate income tax rate in 2018 more than offset the effect of increased profits in 2018, and
- a higher amount of net cash used by relative changes in inventories, receivables, payables and non-tax accruals of \$0.4 million.

Cash provided by operating activities was \$12.6 million in 2017 compared to \$13.9 million in 2016. The \$1.3 million decrease in cash provided by operating activities was primarily the net result of:

- \$0.4 million decrease in operating income in 2017,
- \$1.5 million increase in interest income in 2017,
- \$2.1 million increase in cash paid for taxes in 2017 due to the relative timing of payments and increased profits, and
- a higher amount of net cash used by relative changes in inventories, receivables, payables and non-tax accruals of \$0.3 million.

Relative changes in working capital can have a significant effect on cash flows from operating activities. As shown below, our total average days sales outstanding increased from December 31, 2017 to December 31, 2018 primarily as a result of the timing of sales and collections in the last month of 2018 as compared to 2017. For comparative purposes, we have provided 2016 numbers below.

| | December 31, 2016 | December 31, 2017 | December 31, 2018 |
|-------------------------|----------------------|----------------------|----------------------|
| Days Sales Outstanding: | | | |
| Security Products | 36 Days | 39 Days | 43 Days |
| Marine Components | 33 Days | 31 Days | 30 Days |
| Total | 36 Days | 38 Days | 40 Days |

As shown below, our average number of days in inventory at December 31, 2018 is comparable to December 31, 2017. The variability in days in inventory among our segments primarily relates to the complexity of

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the production processes, and therefore the length of time it takes to produce end products, as well as seasonal cycles. For comparative purposes, we have provided 2016 numbers below.

| | December 31, 2016 | December 31, 2017 | December 31, 2018 |
|--------------------|----------------------|----------------------|----------------------|
| Days in Inventory: | | | |
| Security Products | 73 Days | 76 Days | 77 Days |
| Marine Components | 122 Days | 96 Days | 91 Days |
| Total | 79 Days | 79 Days | 80 Days |

Investing activities. Capital expenditures have primarily emphasized improving our manufacturing facilities and investing in manufacturing equipment, utilizing new technologies and increased automation of the manufacturing process, to provide for increased productivity and efficiency in order to meet expected customer demand and properly maintain our facilities and technology infrastructure. Capital expenditures were \$3.2 million in 2016, \$2.8 million in 2017 and \$3.1 million in 2018. See Note 2 to our Consolidated Financial Statements. Capital expenditures in 2016 include approximately \$1.0 million for an expansion to our Grayslake facility which was completed in April 2016.

Capital expenditures for 2019 are estimated at approximately \$4.8 million primarily to maintain and improve the cost-effectiveness of our facilities and equipment. Capital spending for 2019 is expected to be funded through cash on hand and cash generated from operations.

In August 2016, we entered into an unsecured revolving demand promissory note with Valhi whereby we have agreed to loan Valhi up to \$40 million. Our loan to Valhi, as amended, bears interest at prime rate plus 1.00%, payable quarterly, with all principal due on demand, but in any event no earlier than December 31, 2020. Loans made to Valhi at any time under the agreement are at our discretion. During the third and fourth quarters of 2016, Valhi borrowed a net \$27.4 million under the promissory note (\$36.6 million of gross borrowings and \$9.2 million of gross repayments). During 2017, Valhi borrowed a net \$10.8 million under the promissory note for an outstanding balance of \$38.2 million at December 31, 2017 (\$52.1 million of gross borrowings and \$41.3 million of gross repayments). During 2018, Valhi repaid a net \$4.2 million under the promissory note for an outstanding balance of \$34.0 million at December 31, 2018 (\$46.8 million of gross borrowings and \$51.0 million of gross repayments). See Note 9 to our Consolidated Financial Statements.

Financing activities. Cash dividends paid totaled \$2.5 million (\$.20 per share, or \$.05 per share per quarter) in each of 2016, 2017 and 2018. On February 27, 2019 our board of directors declared a first quarter 2019 dividend of \$.07 per share, to be paid on March 19, 2019 to CompX stockholders of record as of March 11, 2019. The declaration and payment of future dividends and the amount thereof, if any, is discretionary and is dependent upon our results of operations, financial condition, cash requirements for our businesses, contractual requirements and restrictions and other factors deemed relevant by our board of directors. The amount and timing of past dividends is not necessarily indicative of the amount or timing of any future dividends which we might pay.

Future Cash Requirements

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

All of our \$45.4 million aggregate cash and cash equivalents at December 31, 2018 were held in the U.S.

We periodically evaluate our 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, repurchase shares of our common stock, modify our dividend policy or take a combination of such steps to manage our liquidity and capital

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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.

Off balance sheet financing arrangements

Other than certain operating leases discussed in Note 10 to our Consolidated Financial Statements, neither we nor any of our subsidiaries or affiliates are parties to any off-balance sheet financing arrangements.

Commitments and contingencies

As more fully described in the notes to the Consolidated Financial Statements, we are a party to various leases and other agreements that contractually and unconditionally commit us to pay certain amounts in the future. See Note 10 to our Consolidated Financial Statements. The following table summarizes such contractual commitments as of December 31, 2018 by the type and date of payment.

| | Payments due by period | | | | 2024 and after |
|------------------------------------|------------------------|----------|-----------|-----------|-------------------|
| | Total | 2019 | 2020–2021 | 2022–2023 | |
| | (In thousands) | | | | |
| Operating leases | \$275 | \$113 | \$ 162 | \$ - | \$ - |
| Purchase obligations | 12,784 | 10,777 | 2,007 | - | - |
| Income taxes | 1,165 | 1,165 | - | - | - |
| Fixed asset acquisitions | 289 | 289 | - | - | - |
| | | | | | |
| Total contractual cash obligations | \$14,513 | \$12,344 | \$ 2,169 | \$ - | \$ - |

The timing and amount shown for our commitments related to operating leases and fixed asset acquisitions are based upon the contractual payment amount and the contractual payment date for those commitments. The timing and amount shown for purchase obligations, which consist of all open purchase orders and contractual obligations (primarily commitments to purchase raw materials) is also based on the contractual payment amount and the contractual payment date for those commitments. The amount shown for income taxes is the consolidated amount of income taxes payable at December 31, 2018, which is assumed to be paid during 2019. Fixed asset acquisitions include firm purchase commitments for capital projects.

Recent accounting pronouncements

See Note 12 to our Consolidated Financial Statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General. We are exposed to market risk from changes in interest rates and raw materials prices.

Interest rates. We are exposed to market risk from changes in interest rates, primarily related to our note receivable from affiliate. The outstanding principal amount of indebtedness of \$34.0 million at December 31, 2018 bears interest at prime plus 1.0% (6.5% at December 31, 2018). We received interest income of \$2.1 million from the note during 2018.

Raw materials. We will occasionally enter into short term commodity-related raw material supply arrangements to mitigate the impact of future increases in commodity-related raw material costs. We do not have long-term supply agreements for our raw material requirements because either we believe the risk of unavailability of those raw materials is low and we believe the downside risk of price volatility to be too great or because long-term supply agreements for those materials are generally not available. We do not engage in commodity raw material hedging programs.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information called for by this Item is contained in a separate section of this Annual Report. See “Index of Financial Statements” (page F-1).

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. We maintain disclosure controls and procedures which, as defined in Exchange Act Rule 13a-15(e), 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. Our management with the participation of Scott C. James, our President and Chief Executive Officer, and James W. Brown, our Vice President, Chief Financial Officer and Controller, has evaluated the design and operating effectiveness of our disclosure controls and procedures as of December 31, 2018. Based upon their evaluation, these executive officers have concluded that our disclosure controls and procedures are effective as of the date of such evaluation.

Management’s Report on Internal Control Over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting which, as defined in Exchange Act Rule 13a-15(f), 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 generally accepted accounting principles (“GAAP”), and includes those policies and procedures that:

- 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 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 consolidated financial statements.

Our evaluation of the effectiveness of our internal control over financial reporting is based upon the framework established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013 (commonly referred to as the “2013 COSO” framework). Based on our evaluation under that framework, our management has concluded that our internal control over financial reporting was effective as of December 31, 2018.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the SEC that permit us to provide only management's report in this annual report.

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Changes in Internal Control Over Financial Reporting. There have been no changes in our internal control over financial reporting during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Certifications. Our chief executive officer and chief financial officer are required to, among other things, quarterly file a certification with the SEC regarding the quality of our public disclosures, as required by Section 302 of the Sarbanes-Oxley Act of 2002. We have filed the certifications for the quarter ended December 31, 2018 as exhibits 31.1 and 31.2 to this Annual Report on Form 10-K.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item is incorporated by reference to our definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after the end of the fiscal year covered by this report (“Proxy Statement”).

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item is incorporated by reference to our Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item is incorporated by reference to our Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item is incorporated by reference to our Proxy Statement. See also Note 9 to the Consolidated Financial Statements.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item is incorporated by reference to our Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) and (c) Financial Statements

The consolidated financial statements listed on the accompanying Index of Financial Statements (see page F-1) are filed as part of this Annual Report.

All financial statement schedules have been omitted either because they are not applicable or required, or the information that would be required to be included is disclosed in the notes to the consolidated financial statements.

(b) Exhibits

We have retained a signed original of any of these exhibits that contain signatures, and we will provide such exhibits to the Commission or its staff. Included as exhibits are the items listed in the Exhibit Index. We, upon request, will furnish a copy of any of the exhibits listed below upon payment of \$4.00 per exhibit to cover our costs of furnishing the exhibits. Instruments defining the rights of holders of long-term debt issues which do not exceed 10% of consolidated total assets will be furnished to the Commission 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.

Item No. Exhibit Item

- 3.1 Second Amended and Restated Certificate of Incorporation of Registrant – incorporated by reference to Exhibit 3.1 of the Registrant’s Quarterly Report on Form 10-Q for quarter ended June 30, 2018.
- 3.2 Certificate of Retirement – incorporated by reference to Exhibit 3.1 of the Registrant’s Current Report on Form 8-K filed November 5, 2018.
- 3.3 Amended and Restated Bylaws of Registrant, adopted by the Board of Directors October 24, 2007 – incorporated by reference to Exhibit 3.1 of the Registrant’s Current Report on Form 8-K filed October 30, 2007 (File No 1-13905).
- 10.1 Intercorporate Services Agreement between the Registrant and Contran Corporation effective as of January 1, 2004 – incorporated by reference to Exhibit 10.2 of the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2003 (File No. 1-13905) filed on March 4, 2004.
- 10.2* CompX International Inc. 2012 Director Stock Plan – incorporated by reference to Exhibit 10.2 of the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 1-13905) filed on March 6, 2013.
- 10.3 Tax Sharing Agreement between the Registrant, NL Industries, Inc. and Contran Corporation dated as of December 1, 2012 - incorporated by reference to Exhibit 10.3 of the Registrant’s Annual Report on Form 10-K for the year ended December 31, 2012 (File No. 1-13905) filed on March 6, 2013.
- 10.4** Second Amended and Restated Agreement Regarding Shared Insurance among the Registrant, Contran Corporation, Kronos Worldwide, Inc., NL Industries, Inc., and Valhi.Inc. dated January 25, 2019.

- 10.5** Unsecured Revolving Demand Promissory Note dated December 31, 2018 in the original principal amount of \$40 million executed by Valhi, Inc. and payable to the Registrant.
- 10.6* Form of Indemnification Agreement – incorporated by reference to Exhibit 10.1 of the Registrant’s Current Report on Form 8-K filed May 26, 2016 (File No 1-13905).

| Item No. | Exhibit Item (continued) |
|-----------|---|
| 21.1** | <u>Subsidiaries of the Registrant.</u> |
| 23.1** | <u>Consent of PricewaterhouseCoopers LLP.</u> |
| 31.1** | <u>Certification</u> |
| 31.2** | <u>Certification</u> |
| 32.1** | <u>Certification</u> |
| 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 |

*Management contract, compensatory plan or agreement.

** Filed herewith.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Date: February 27, 2019 By: /s/ Scott C. James
 Scott C. James
 President and Chief Executive Officer
 (Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons in the capacities and on the dates indicated.

| Signature | Title | Date |
|--|--|-------------------|
| /s/ Loretta J. Feehan Loretta J. Feehan | Chair of the Board | February 27, 2019 |
| /s/ Robert D. Graham Robert D. Graham | Vice Chairman of the Board | February 27, 2019 |
| /s/ James W. Brown James W. Brown | Vice President, Chief Financial Officer and Controller (Principal Financial and Accounting Officer) | February 27, 2019 |
| /s/ Thomas E. Barry Thomas E. Barry | Director | February 27, 2019 |
| /s/ David A. Bowers David A. Bowers | Director | February 27, 2019 |
| /s/ Terri L. Herrington Terri L. Herrington | Director | February 27, 2019 |
| /s/ Ann Manix Ann Manix | Director | February 27, 2019 |
| /s/ Cecil H. Moore, Jr. Cecil H. Moore, Jr. | Director | February 27, 2019 |
| /s/ Mary A. Tidlund Mary A. Tidlund | Director | February 27, 2019 |

Annual Report on Form 10-K

Items 8 and 15(a)

Index of Financial Statements

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All financial statement schedules have been omitted either because they are not applicable or required, or the information that would be required to be included is disclosed in the notes to the consolidated financial statements.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of CompX International Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of CompX International Inc. and its subsidiaries (the “Company”) as of December 30, 2018 and December 31, 2017, and the related consolidated statements of income, stockholders’ equity and cash flows for each of the three years in the period ending December 30, 2018, including the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 30, 2018 and December 31, 2017, and the results of its operations and its cash flows for each of the three years in the period ending December 30, 2018 in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits of these consolidated financial statements in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by

management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Dallas, Texas

February 27, 2019

We have served as the Company's auditor since 1993.

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COMPX INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

| ASSETS | December 31, | |
|--------------------------------|--------------|-----------|
| | 2017 | 2018 |
| Current assets: | | |
| Cash and cash equivalents | \$29,655 | \$45,414 |
| Accounts receivable, net | 10,446 | 12,140 |
| Inventories | 15,382 | 17,102 |
| Prepaid expenses and other | 879 | 1,629 |
| Total current assets | 56,362 | 76,285 |
| Other assets: | | |
| Note receivable from affiliate | 38,200 | 34,000 |
| Goodwill | 23,742 | 23,742 |
| Other noncurrent | 590 | 590 |
| Total other assets | 62,532 | 58,332 |
| Property and equipment: | | |
| Land | 4,935 | 4,940 |
| Buildings | 22,774 | 22,835 |
| Equipment | 67,373 | 67,073 |
| Construction in progress | 569 | 603 |
| | 95,651 | 95,451 |
| Less accumulated depreciation | 63,586 | 63,639 |
| Net property and equipment | 32,065 | 31,812 |
| Total assets | \$150,959 | \$166,429 |

COMPX INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (CONTINUED)

(In thousands, except share data)

| LIABILITIES AND STOCKHOLDERS' EQUITY | December 31, | |
|---|--------------|-----------|
| | 2017 | 2018 |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | \$10,792 | \$12,504 |
| Income taxes payable to affiliate | 470 | 1,165 |
| Total current liabilities | 11,262 | 13,669 |
| Noncurrent liabilities - | | |
| Deferred income taxes | 3,112 | 3,198 |
| Stockholders' equity: | | |
| Preferred stock, \$.01 par value; 1,000 shares authorized, none issued | - | - |
| Class A common stock, \$.01 par value; 20,000,000 shares authorized; 2,426,107 and 12,435,557 shares issued and outstanding | 24 | 124 |
| Class B common stock, \$.01 par value; 10,000,000 and nil shares authorized, 10,000,000 and nil issued and outstanding | 100 | - |
| Additional paid-in capital | 55,612 | 55,751 |
| Retained earnings | 80,849 | 93,687 |
| Total stockholders' equity | 136,585 | 149,562 |
| Total liabilities and stockholders' equity | \$150,959 | \$166,429 |

Commitments and contingencies (Note 10)

See accompanying Notes to Consolidated Financial Statements.

COMPX INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

| | Years ended December 31, | | |
|---|--------------------------|-----------|-----------|
| | 2016 | 2017 | 2018 |
| Net sales | \$108,920 | \$112,035 | \$118,217 |
| Cost of goods sold | 73,753 | 77,210 | 79,946 |
| Gross profit | 35,167 | 34,825 | 38,271 |
| Selling, general and administrative expense | 19,593 | 19,590 | 20,460 |
| Operating income | 15,574 | 15,235 | 17,811 |
| Interest income | 390 | 1,929 | 2,664 |
| Income before income taxes | 15,964 | 17,164 | 20,475 |
| Provision for income taxes | 5,507 | 3,961 | 5,150 |
| Net income | \$10,457 | \$13,203 | \$15,325 |
| Basic and diluted earnings per common share | \$0.84 | \$1.06 | \$1.23 |
| Cash dividends per share | \$0.20 | \$0.20 | \$0.20 |
| Basic and diluted weighted average shares outstanding | 12,416 | 12,423 | 12,432 |

See accompanying Notes to Consolidated Financial Statements.

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COMPX INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

| | Years ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2016 | 2017 | 2018 |
| Cash flows from operating activities: | | | |
| Net income | \$10,457 | \$13,203 | \$15,325 |
| Depreciation and amortization | 3,698 | 3,673 | 3,454 |
| Deferred income taxes | (114) | (1,775) | 86 |
| Other, net | 330 | 181 | 289 |
| Change in assets and liabilities: | | | |
| Accounts receivable, net | (1,596) | (115) | (1,709) |
| Inventories, net | (37) | (473) | (1,846) |
| Accounts payable and accrued liabilities | 153 | (962) | 1,619 |
| Accounts with affiliates | 970 | (971) | 152 |
| Other, net | 3 | (178) | (207) |
| Net cash provided by operating activities | 13,864 | 12,583 | 17,163 |
| Cash flows from investing activities: | | | |
| Capital expenditures | (3,175) | (2,796) | (3,117) |
| Note receivable from affiliate: | | | |
| Collections | 9,200 | 41,300 | 51,000 |
| Advances | (36,600) | (52,100) | (46,800) |
| Net cash provided by (used in) investing activities | (30,575) | (13,596) | 1,083 |
| Cash flows from financing activities - | | | |
| Dividends paid | (2,483) | (2,485) | (2,487) |
| Net increase (decrease) | (19,194) | (3,498) | 15,759 |
| Balance at beginning of year | 52,347 | 33,153 | 29,655 |
| Balance at end of year | \$33,153 | \$29,655 | \$45,414 |
| Supplemental disclosures - | | | |
| Cash paid for income taxes | \$4,646 | \$6,709 | \$4,370 |

See accompanying Notes to Consolidated Financial Statements.

COMPX INTERNATIONAL INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Years ended December 31, 2016, 2017 and 2018

(In thousands)

| | Common stock | | Additional paid-in | Retained | Total |
|------------------------------|-----------------|------------|-----------------------|----------|-------------------------|
| | Class A | Class B | capital | earnings | stockholders' equity |
| Balance at December 31, 2015 | 24 | 100 | 55,422 | 62,157 | 117,703 |
| Net income | - | - | - | 10,457 | 10,457 |
| Cash dividends | - | - | - | (2,483) | (2,483) |
| Issuance of common stock | - | - | 93 | - | 93 |
| Balance at December 31, 2016 | 24 | 100 | 55,515 | 70,131 | 125,770 |
| Net income | - | - | - | 13,203 | 13,203 |
| Cash dividends | - | - | - | (2,485) | (2,485) |
| Issuance of common stock | - | - | 97 | - | 97 |
| Balance at December 31, 2017 | 24 | 100 | 55,612 | 80,849 | 136,585 |
| Net income | - | - | - | 15,325 | 15,325 |
| Share conversion | 100 | (100) | - | - | - |
| Cash dividends | - | - | - | (2,487) | (2,487) |
| Issuance of common stock | - | - | 139 | - | 139 |
| Balance at December 31, 2018 | \$124 | \$- | \$ 55,751 | \$93,687 | \$ 149,562 |

See accompanying Notes to Consolidated Financial Statements.

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COMPX INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2018

Note 1 – Summary of significant accounting policies:

Organization. We (NYSE American: CIX) are 87% owned by NL Industries, Inc. (NYSE: NL) at December 31, 2018. We manufacture and sell component products (security products and recreational marine components). At December 31, 2018, Valhi, Inc. (NYSE: VHI) owns 83% of NL's outstanding common stock and a wholly-owned subsidiary of Contran Corporation owns 92% of Valhi's outstanding common stock. All of Contran's outstanding voting stock is held by a family trust established for the benefit of Lisa K. Simmons and Serena Simmons Connelly and their children, for which Ms. Simmons and Ms. Connelly are co-trustees, or is held directly by Ms. Simmons and Ms. Connelly or entities related to them. Consequently, Ms. Simmons and Ms. Connelly may be deemed to control Contran, Valhi, NL and us.

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

Management estimates. In preparing our financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at each balance sheet date and the reported amounts of our revenues and expenses during each reporting period. Actual results may differ significantly from previously estimated amounts under different assumptions or conditions.

Principles of consolidation. Our consolidated financial statements include the accounts of CompX International Inc. and our wholly-owned subsidiaries. We eliminate all material intercompany accounts and balances.

Fiscal year. Our fiscal year end is always the Sunday closest to December 31, and our operations are reported on a 52 or 53-week fiscal year. Each of the years ended December 31, 2016, 2017 and 2018 consisted of 52 weeks. For presentation purposes, annual and quarterly information in the consolidated financial statements and accompanying notes are presented as ended on March 31, June 30, September 30 and December 31, as applicable. The actual date of our fiscal years ended December 31, 2016, 2017 and 2018 are January 1, 2017, December 31, 2017, and December 30, 2018, respectively.

Cash and cash equivalents. We classify bank time deposits and government and commercial notes and bills with original maturities of three months or less as cash equivalents.

Net sales. Our sales involve single performance obligations to ship our products pursuant to customer purchase orders. In some cases, the purchase order is supported by an underlying master sales agreement, but our purchase order verification notice generally evidences the contract with our customer by specifying the key terms of product and quantity ordered, price and delivery and payment terms. Effective January 1, 2018 with the adoption of

Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (see Note 12), we record revenue when we satisfy our performance obligations to our customers by transferring control of our products to them, which generally occurs at point of shipment or upon delivery. Such transfer of control is also evidenced by transfer of legal title and other risks and rewards of ownership (giving the customer the ability to direct the use of, and obtain substantially all of the benefits of, the product), and our customers becoming obligated to pay us and such payment being probable of occurring. In certain arrangements we provide shipping and handling activities after the transfer of control to our customer (e.g. when control transfers prior to delivery). In such arrangements shipping and handling are considered fulfillment activities, and accordingly, such costs are accrued when the related revenue is recognized. Prior to the adoption of ASU 2014-09, we recorded sales when our products were shipped and title and other risks and rewards of ownership had passed to the customer, which was generally at the time of shipment (although in some instances shipping terms were FOB destination point, for which we did not recognize revenue until the product was received by our customers).

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Revenue is recorded in an amount that reflects the net consideration we expect to receive in exchange for our products. Prices for our products are based on terms specified in published list prices and purchase orders, which generally do not include financing components, noncash consideration or consideration paid to our customers. As our standard payment terms are less than one year, we have elected the practical expedient under ASC 606 and we have not assessed whether a contract has a significant financing component. We state sales net of price, early payment and distributor discounts as well as volume rebates (collectively, variable consideration). Variable consideration, to the extent present, is not material and is recognized as the amount to which we are most-likely to be entitled, using all information (historical, current and forecasted) that is reasonably available to us, and only to the extent that a significant reversal in the amount of the cumulative revenue recognized is not probable of occurring in a future period. Differences, if any, between estimates of the amount of variable consideration to which we will be entitled and the actual amount of such variable consideration have not been material in the past. We report any tax assessed by a governmental authority that we collect from our customers that is both imposed on and concurrent with our revenue-producing activities (such as sales, use, value added and excise taxes) on a net basis (meaning we do not recognize these taxes either in our revenues or in our costs and expenses).

Frequently, we receive orders for products to be delivered over dates that may extend across reporting periods. We invoice for each delivery upon shipment and recognize revenue for each distinct shipment when all sales recognition criteria for that shipment have been satisfied. As scheduled delivery dates for these orders are within a one year period, under the optional exemption provided by ASC 606, we do not disclose sales allocated to future shipments of partially completed contracts.

ASU 2014-09 requires a disaggregation of our sales into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. We have determined such disaggregation of our sales is the same as the disclosure of our sales by segment. See Note 2.

Accounts receivable. We provide an allowance for doubtful accounts for known and estimated potential losses arising from our sales to customers based on a periodic review of these accounts.

Inventories and cost of sales. We state inventories at the lower of cost or net realizable value. We record a provision for obsolete and slow-moving inventories. We generally base inventory costs for all inventory categories on average cost that approximates the first-in, first-out method. Inventories include the costs for raw materials, the cost to manufacture the raw materials into finished goods and overhead. Depending on the inventory's stage of completion, our manufacturing costs can include the costs of packing and finishing, utilities, maintenance and depreciation, shipping and handling, and salaries and benefits associated with our manufacturing process. We allocate fixed manufacturing overhead costs based on normal production capacity. Unallocated overhead costs resulting from periods with abnormally low production levels are charged to expense as incurred. As inventory is sold to third parties, we recognize the cost of sales in the same period that the sale occurs. We periodically review our inventory for estimated obsolescence or instances when inventory is no longer marketable for its intended use, and we record any write-down, equal to the difference between the cost of inventory and its estimated net realizable value, based on assumptions about alternative uses, market conditions and other factors.

Selling, general and administrative expenses; advertising costs. Selling, general and administrative expenses include costs related to marketing, sales, distribution, research and development and administrative functions such as accounting, treasury and finance, and include costs for salaries and benefits, travel and entertainment, promotional materials and professional fees. We expense advertising and research and development costs as incurred. Advertising

costs were not significant in 2016, 2017 or 2018.

Goodwill. Goodwill represents the excess of cost over fair value of individual net assets acquired in business combinations. Goodwill is not subject to periodic amortization. We evaluate goodwill for impairment annually or when circumstances indicate the carrying value may not be recoverable. See Note 5.

Property and equipment; depreciation expense. We state property and equipment, including purchased computer software for internal use, at cost. We compute depreciation of property and equipment for financial reporting purposes principally by the straight-line method over the estimated useful lives of 15 to 40 years for buildings and 3 to 20 years for equipment and software. We use accelerated depreciation methods for income tax

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purposes, as permitted. Upon sale or retirement of an asset, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is recognized in income currently. Expenditures for maintenance, repairs and minor renewals are expensed; expenditures for major improvements are capitalized.

We perform impairment tests when events or changes in circumstances indicate the carrying value may not be recoverable. We consider all relevant factors. We perform the impairment test by comparing the estimated future undiscounted cash flows associated with the asset to the asset's net carrying value to determine if impairment exists.

Employee benefit plans. We maintain various defined contribution plans in which we make contributions based on matching or other formulas. Defined contribution plan expense approximated \$2.6 million in 2016, \$2.4 million in 2017 and \$3.0 million in 2018.

Self-insurance. We are partially self-insured for workers' compensation and certain employee health benefits and self-insured for most environmental issues. We purchase coverage in order to limit our exposure to significant workers' compensation or employee health benefit claims. We accrue self-insured losses based upon estimates of the aggregate liability for uninsured claims incurred using certain actuarial assumptions followed in the insurance industry and our own historical claims experience.

Income taxes. We, and our parent NL, are members of the Contran Tax Group. We have been and currently are a part of the consolidated tax returns filed by Contran for U.S. federal purposes as well as for certain U.S. state jurisdictions. As a member of the Contran Tax Group, we are jointly and severally liable for the federal income tax liability of Contran and the other companies included in the Contran Tax Group for all periods in which we are included in the Contran Tax Group. See Note 10.

As a member of the Contran Tax Group, we are a party to a tax sharing agreement which provides that we compute our provision for U.S. income taxes on a separate-company basis. Pursuant to the tax sharing agreement, we make payments to or receive payments from NL in amounts we would have paid to or received from the U.S. Internal Revenue Service or the applicable state tax authority had we not been a member of the Contran Tax Group. The separate company provisions and payments are computed using the tax elections made by Contran. We made net cash payments for income taxes to NL of \$4.6 million in 2016, \$6.7 million in 2017 and \$4.3 million in 2018.

Deferred income tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the income tax and financial reporting carrying amounts of assets and liabilities. Deferred income tax assets and liabilities for each tax-paying jurisdiction in which we operate are netted and presented as either a noncurrent deferred income tax asset or liability, as applicable. We periodically evaluate our deferred tax assets in the various taxing jurisdictions in which we operate and adjust any related valuation allowance based on the estimate of the amount of deferred tax assets which we believe do not meet the more-likely-than-not recognition criteria. See Notes 7 and 10.

We record a reserve for uncertain tax positions for tax positions where we believe it is more-likely-than-not our position will not prevail with the applicable tax authorities. We did not have a reserve for uncertain tax positions in each of 2016, 2017 and 2018.

Note 2 – Business and geographic segments:

Our operating segments are defined as components of our operations about which separate financial information is available that is regularly evaluated by our chief operating decision maker in determining how to allocate resources and in assessing performance. At December 31, 2018, we had two reportable operating segments – Security Products and Marine Components.

The Security Products segment, with a facility in South Carolina and a facility shared with Marine Components in Illinois, manufactures locking mechanisms and other security products for sale to the transportation, postal, office and institutional furniture, cabinetry, tool storage, healthcare and other industries.

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Our Marine Components segment, with a facility in Wisconsin and a facility shared with Security Products in Illinois, manufactures and distributes stainless steel exhaust systems, gauges, throttle controls, wake enhancement systems, trim tabs and related hardware and accessories primarily for performance and ski/wakeboard boats.

The chief operating decision maker evaluates segment performance based on segment operating income, which is defined as income before income taxes, exclusive of certain general corporate income and expense items (primarily interest income) and certain non-recurring items (such as gains or losses on the disposition of long-lived assets outside the ordinary course of business). The accounting policies of the reportable operating segments are the same as those described in Note 1. Capital expenditures include additions to property and equipment, but exclude amounts attributable to business combinations.

Segment assets are comprised of all assets attributable to the reportable segments. Corporate assets are not attributable to the operating segments and consist primarily of cash, cash equivalents and note receivable from affiliate. For geographic information, the point of origin (place of manufacture) for all net sales is the U.S., the point of destination for net sales is based on the location of the customer, and property and equipment are attributable to their physical location. Intersegment sales are not material.

| | Years ended December 31, | | |
|--------------------------------|--------------------------|-----------|-----------|
| | 2016 | 2017 | 2018 |
| | (In thousands) | | |
| Net sales: | | | |
| Security Products | \$94,693 | \$96,600 | \$98,383 |
| Marine Components | 14,227 | 15,435 | 19,834 |
| Total | \$108,920 | \$112,035 | \$118,217 |
| Operating income (loss): | | | |
| Security Products | \$19,981 | \$19,182 | \$21,947 |
| Marine Components | 1,707 | 1,342 | 2,738 |
| Corporate | (6,114) | (5,289) | (6,874) |
| Total operating income | 15,574 | 15,235 | 17,811 |
| Interest income | 390 | 1,929 | 2,664 |
| Income before income taxes | \$15,964 | \$17,164 | \$20,475 |
| Depreciation and amortization: | | | |
| Security Products | \$3,025 | \$3,072 | \$2,914 |
| Marine Components | 663 | 591 | 535 |
| Corporate | 10 | 10 | 5 |
| Total | \$3,698 | \$3,673 | \$3,454 |
| Capital expenditures: | | | |
| Security Products | \$3,017 | \$2,389 | \$2,126 |

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| | | | |
|-------------------|---------|---------|---------|
| Marine Components | 153 | 405 | 991 |
| Corporate | 5 | 2 | - |
| Total | \$3,175 | \$2,796 | \$3,117 |

Net sales point of destination:

| | | | |
|---------------|----------|-----------|-----------|
| United States | \$98,526 | \$103,646 | \$108,773 |
| Canada | 7,515 | 5,353 | 6,436 |
| Mexico | 1,315 | 1,486 | 1,438 |
| Other | 1,564 | 1,550 | 1,570 |

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Total \$108,920 \$112,035 \$118,217

| | December 31, | | |
|----------------------------|--------------|-----------|-----------|
| | 2016 | 2017 | 2018 |
| Total assets: | | | |
| Security Products | \$73,345 | \$72,961 | \$74,714 |
| Marine Components | 12,209 | 11,704 | 14,189 |
| Corporate and eliminations | 58,426 | 66,294 | 77,526 |
| | | | |
| Total | \$143,980 | \$150,959 | \$166,429 |

Net property and equipment for 2016, 2017 and 2018 is entirely located in the United States.

Note 3 – Accounts receivable, net:

| | December 31, | |
|---------------------------------|----------------|----------|
| | 2017 | 2018 |
| | (In thousands) | |
| Account receivable, net: | | |
| Security Products | \$9,341 | \$10,596 |
| Marine Components | 1,175 | 1,614 |
| Allowance for doubtful accounts | (70) | (70) |
| | | |
| Total accounts receivable, net | \$10,446 | \$12,140 |

Note 4 – Inventories:

| | December 31, | |
|-------------------|----------------|---------|
| | 2017 | 2018 |
| | (In thousands) | |
| Raw materials: | | |
| Security Products | \$2,156 | \$2,001 |
| Marine Components | 574 | 660 |

| | | |
|-----------------------|----------|----------|
| Total raw materials | 2,730 | 2,661 |
| Work-in-process: | | |
| Security Products | 8,290 | 9,018 |
| Marine Components | 1,546 | 2,112 |
| Total work-in-process | 9,836 | 11,130 |
| Finished goods: | | |
| Security Products | 2,079 | 2,363 |
| Marine Components | 737 | 948 |
| Total finished goods | 2,816 | 3,311 |
| Total inventories | \$15,382 | \$17,102 |

Note 5 – Goodwill:

We assign goodwill based on reporting unit (as that term is defined in ASC Topic 350-20-20, Goodwill) which corresponds to our operating segments. All of our net goodwill relates to our Security Products segment and was generated from acquisitions relating to our Security Products segment prior to 2001. We test for goodwill impairment at the reporting unit level. In accordance with the requirements of ASC Topic 350-20-20, we review goodwill for each of our reporting units for impairment during the third quarter of each year or when circumstances arise that indicate an impairment might be present.

In 2016, 2017 and 2018, our goodwill was tested for impairment only in the third quarter of each year in connection with our annual testing date. No impairment was indicated as part of such annual reviews of goodwill. As permitted by GAAP, during 2017 and 2018 we used the qualitative assessment of ASC 350-20-35 for our annual impairment test and determined it was not necessary to perform the quantitative goodwill impairment test. During 2016, we used the quantitative assessment of ASC 350-20-35 for our annual impairment test using discounted cash flows to determine the estimated fair value of our Security Products reporting unit. Such discounted cash flows are a Level 3 input as defined by ASC 820-10-35.

Our gross goodwill at December 31, 2018 is \$33.6 million. Prior to 2016, we recorded a \$9.9 million goodwill impairment in our Marine Components segment resulting in a net consolidated carrying amount of \$23.7 million. There have been no changes in the carrying amount of our goodwill during the past three years.

Note 6 – Accounts payable and accrued liabilities:

| | December 31, | |
|----------------------------|----------------|--------------|
| | 2017 | 2018 |
| | (In thousands) | |
| Accounts payable: | | |
| Security Products | \$1,897 | \$2,708 |
| Marine Components | 375 | 527 |
| Accrued liabilities: | | |
| Employee benefits | 7,413 | 8,068 |
| Customer tooling | 290 | 334 |
| Taxes other than on income | 289 | 328 |
| Insurance | 117 | 108 |
| Sales rebates | 135 | 156 |
| Other | 276 | 275 |
| Total | \$10,792 | \$12,504 |

Note 7 – Income taxes:

The provision for income taxes and the difference between such provision for income taxes and the amount that would be expected using the U.S. federal statutory income tax rate of 35% in 2016 and 2017 and 21% in 2018 are presented below. All of our pre-tax income relates to operations in the United States.

| | Years ended December 31, | | |
|--|--------------------------|---------|---------|
| | 2016 | 2017 | 2018 |
| | (In thousands) | | |
| Provision for income taxes: | | | |
| Currently payable | \$5,621 | \$5,736 | \$5,064 |
| Deferred income tax expense (benefit) | (114) | (1,775) | 86 |
| Total | \$5,507 | \$3,961 | \$5,150 |
| Expected tax expense, at the U.S. federal statutory income tax rate of 35% in 2016 and 2017, 21% in 2018 | | | |
| Changes in federal tax rate, net | \$5,588 | \$6,007 | \$4,300 |
| State income taxes | - | (1,861) | - |
| Domestic production activities deduction | 388 | 235 | 812 |
| Other, net | (495) | (505) | - |
| Total | 26 | 85 | 38 |
| Total | \$5,507 | \$3,961 | \$5,150 |

On December 22, 2017, H.R.1, formally known as the “Tax Cuts and Jobs Act” (“2017 Tax Act”) was enacted into law. This tax legislation, among other changes, (i) reduced the federal corporate income tax rate from 35% to 21% effective January 1, 2018; (ii) eliminated the domestic production activities deduction beginning in 2018; and (iii) allows for the expensing of certain capital expenditures. Following the enactment of the 2017 Tax Act, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) 118 to provide guidance on the accounting and reporting impacts of the 2017 Tax Act. SAB 118 required that companies account for changes related to the 2017 Tax Act in the period of enactment unless the impact of such changes could not be reasonably estimated. Where the use of estimated provisional amounts was necessary, SAB 118 provided for a measurement period of no longer than one year during which companies could adjust those amounts as additional information became available. Therefore, as required under GAAP, we revalued our net deferred tax liability associated with our net taxable temporary differences based on deferred tax balances as of the enactment date to reflect the effect of the reduction in the corporate income tax rate. Our temporary differences as of December 31, 2017 were not materially different from our temporary differences as of the enactment date, accordingly revaluation of our net taxable temporary differences was based on our net deferred tax liability as of December 31, 2017. Such revaluation resulted in a non-cash deferred income tax benefit of approximately \$1.9 million recognized in continuing operations for the period ended December 31, 2017, reducing our net deferred income tax liability as of that date. During 2018 we finalized our analysis of the 2017 Tax Act and recorded an immaterial adjustment within the defined measurement period. See also Note 10 to our Consolidated Financial Statements.

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The components of the net deferred tax liability are summarized below.

| | December 31, | |
|--|----------------|-----------|
| | 2017 | 2018 |
| | (In thousands) | |
| Tax effect of temporary differences related to: | | |
| Inventories | \$347 | \$356 |
| Property and equipment | (2,796) | (2,912) |
| Accrued liabilities and other deductible differences | 23 | 25 |
| Accrued employee benefits | 1,009 | 1,032 |
| Goodwill | (1,691) | (1,693) |
| Other taxable differences | (4) | (6) |
| | | |
| Total deferred tax liability | \$(3,112) | \$(3,198) |

We and Contran file income tax returns in U.S. federal and various state and local jurisdictions. Our income tax returns prior to 2015 are generally considered closed to examination by applicable tax authorities.

Note 8 – Stockholders’ equity:

| | Shares of common stock | |
|------------------------------|---------------------------|---------------------------|
| | Class A | Class B |
| | Issued and outstanding | Issued and outstanding |
| Balance at December 31, 2015 | 2,411,107 | 10,000,000 |
| Issued | 8,000 | - |
| Balance at December 31, 2016 | 2,419,107 | 10,000,000 |
| Issued | 7,000 | - |
| Balance at December 31, 2017 | 2,426,107 | 10,000,000 |
| Share conversion | 10,000,000 | (10,000,000) |
| Issued | 9,450 | - |
| Balance at December 31, 2018 | 12,435,557 | - |

Class A and Class B common stock. At our 2018 annual meeting of stockholders held May 23, 2018, our stockholders approved our second amended and restated certificate of incorporation, which among other things added a right for each holder of shares of our Class B common stock, at its option, to convert any or all of those shares into the same number of shares of our Class A common stock. Previously, shares of our Class B common stock were convertible into the same number of Class A common shares only under certain specified conditions. The shares of our Class A and Class B common stock were otherwise identical in all respects, except for certain voting rights in which holders of our shares of Class B common stock were entitled to ten votes per share for election of our directors and one vote per share on all other matters presented to our stockholders for their approval. Holders of our shares of Class A common stock are entitled to one vote per share on all matters. Our second amended and restated certificate of incorporation became effective on July 17, 2018 when we filed such certificate with the Delaware Secretary of

State. Immediately after such effectiveness, NL, which owned all of the 10,000,000 issued and outstanding shares of our Class B common stock, converted such Class B shares into 10,000,000 shares of our Class A common stock. This conversion eliminated the dual-class voting structure with respect to election of our directors, providing for equal voting rights with respect to the election of directors for all shares of common stock and providing for uniform and equivalent corporate governance rights to all holders of our common stock. The rights of holders of Class A common stock were not otherwise affected, and the conversion did not affect the calculation of our earnings per share and had no impact on our consolidated financial position, results of operations or liquidity. The second amended and restated certificate of incorporation did not permit the reissuance or resale of any of the shares of Class B common stock which were converted. On November 5, 2018, upon the filing of a Certificate of Retirement with respect to the shares of Class B common stock with the Delaware Secretary of State, the shares of Class B common stock were retired, and our second amended and restated certificate of incorporation was amended to eliminate all references to the Class B common stock. Following the conversion and subsequent

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retirement of our shares of Class B common stock, our authorized capital stock consists of 20,000,000 shares of Class A common stock and 1,000 shares of preferred stock.

Share repurchases and cancellations. Prior to 2016, our board of directors authorized various repurchases of shares of our Class A common stock in open market transactions, including block purchases, or in privately-negotiated transactions at unspecified prices and over an unspecified period of time. We may repurchase our common stock from time to time as market conditions permit. The stock repurchase program does not include specific price targets or timetables and may be suspended at any time. Depending on market conditions, we may terminate the program prior to its completion. We will generally use cash on hand to acquire the shares. Repurchased shares will be added to our treasury and cancelled. We made no treasury purchases during 2016, 2017 or 2018 and at December 31, 2018, approximately 678,000 shares were available for purchase under these authorizations.

Incentive compensation plan. We have a share based incentive compensation plan pursuant to which an aggregate of up to 200,000 shares of our common stock can be awarded to non-employee members of our board of directors. All of the Class A common shares we issued in 2016, 2017 and 2018 were issued under this plan. At December 31, 2018, 156,550 shares were available for award under this plan.

Dividends. We paid regular quarterly dividends of \$.05 per share during 2016, 2017 and 2018. Declaration and payment of future dividends and the amount thereof, if any, is discretionary and dependent upon our results of operations, financial condition, cash requirements for our businesses, contractual requirements and restrictions and other factors deemed relevant by our board of directors.

Note 9 – Related party transactions:

We may be deemed to be controlled by Ms. Lisa Simmons and Ms. Serena Connelly. See Note 1. Corporations that may be deemed to be controlled by or affiliated with these individuals sometimes engage in (a) intercorporate transactions such as guarantees, management and expense sharing arrangements, shared fee arrangements, joint ventures, partnerships, loans, options, advances of funds on open account, and sales, leases and exchanges of assets, including securities issued by both related and unrelated parties and (b) common investment and acquisition strategies, business combinations, reorganizations, recapitalizations, securities repurchases, and purchases and sales (and other acquisitions and dispositions) of subsidiaries, divisions or other business units, which transactions have involved both related and unrelated parties and have included transactions that resulted in the acquisition by one related party of a publicly-held minority equity interest in another related party. We continuously consider, review and evaluate, and understand that Contran and related entities consider, review and evaluate such transactions. Depending upon the business, tax and other objectives then relevant, it is possible that we might be a party to one or more such transactions in the future.

From time to time, we may have loans and advances outstanding between us and various related parties pursuant to term and demand notes. We generally enter into these loans and advances for cash management purposes. When we loan funds to related parties, we are generally able to earn a higher rate of return on the loan than we would earn if we invested the funds in other instruments. While certain of these loans may be of a lesser credit quality than cash equivalent instruments otherwise available to us, we believe we have evaluated the credit risks in the terms of the applicable loans. In this regard, in August 2016, we entered into an unsecured revolving demand promissory note with Valhi whereby we have agreed to loan Valhi up to \$40 million. Our loan to Valhi, as amended, bears interest at prime plus 1.00%, payable quarterly, with all principal due on demand, but in any event no earlier than December 31, 2020. Loans made to Valhi at any time under the agreement are at our discretion. At December 31, 2017 and 2018, the outstanding principal balance receivable from Valhi under the promissory note was \$38.2 million and \$34.0

million, respectively. Interest income (including unused commitment fees) on our loan to Valhi was \$0.2 million in 2016, \$1.8 million in 2017 and \$2.1 million in 2018. On December 31, 2018 (one day after our 2018 fiscal year, but on the last day of the fiscal year for Valhi), we loaned \$6.0 million to Valhi, increasing the outstanding principal balance receivable from Valhi under the promissory note to \$40.0 million.

Under the terms of an Intercorporate Service Agreement (“ISA”) with Contran, employees of Contran perform certain management, tax planning, financial, legal and administrative services for us on a fee basis. Such fees are based upon estimates of time devoted to our affairs by individual Contran employees and the compensation

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of such persons. Because of the large number of companies affiliated with Contran, we believe we benefit from cost savings and economies of scale gained by not having certain management, financial and administrative staffs duplicated at each entity, thus allowing certain individuals to provide services to multiple companies but only be compensated by one entity. Fees pursuant to these agreements aggregated \$3.1 million in 2016, \$2.8 million in 2017 and \$3.5 million in 2018.

Contran and certain of its subsidiaries and affiliates, including us, purchase certain of their insurance policies as a group, with the costs of the jointly-owned policies being apportioned among the participating companies. Tall Pines Insurance Company (“Tall Pines”) and EWI RE, Inc. (“EWI”), each subsidiaries of Valhi, provide for or broker certain insurance policies for Contran and certain of its subsidiaries and affiliates, including us. Tall Pines purchases reinsurance from third-party insurance carriers with an A.M. Best Company rating of generally at least A-(Excellent) for substantially all of the risks it underwrites. Consistent with insurance industry practices, Tall Pines and EWI receive commissions from the insurance and reinsurance underwriters and/or assess fees for the policies that they provide or broker. The aggregate premiums we paid to Tall Pines and EWI were approximately \$1.7 million in 2016, \$2.2 million in 2017 and \$2.0 million in 2018. These amounts principally represent payments for insurance premiums, which include premiums or fees paid to Tall Pines or fees paid to EWI. These amounts also include payments to insurers or reinsurers through EWI for the reimbursement of claims within our applicable deductible or retention ranges that such insurers or reinsurers paid to third parties on our behalf, as well as amounts for claims and risk management services and various other third-party fees and expenses incurred by the program. We expect that these relationships with Tall Pines and EWI will continue in 2019.

With respect to certain of such jointly-owned insurance policies, it is possible that unusually large losses incurred by one or more insureds during a given policy period could leave the other participating companies without adequate coverage under that policy for the balance of the policy period. As a result, and in the event that the available coverage under a particular policy would become exhausted by one or more claims, Contran and certain of its subsidiaries and affiliates, including us, have entered into a loss sharing agreement under which any uninsured loss arising because the available coverage had been exhausted by one or more claims will be shared ratably amongst those entities that had submitted claims under the relevant policy. We believe the benefits in the form of reduced premiums and broader coverage associated with the group coverage for such policies justifies the risk associated with the potential for any uninsured loss.

Note 10 – Commitments and contingencies:

Legal proceedings. We are involved, from time to time, in various environmental, 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.

Environmental matters and litigation. Our operations are governed by various federal, state and local environmental laws and regulations. Our policy is to comply with environmental laws and regulations at all of our facilities and to continually strive to improve environmental performance in association with applicable industry initiatives. We believe that our operations are in substantial compliance with applicable requirements of environmental laws. From time to time, we may be subject to environmental regulatory enforcement under various statutes, resolution of which typically involves the establishment of compliance programs.

Income taxes. From time to time, we undergo examinations of our income tax returns, and tax authorities have or may propose tax deficiencies. We believe that we have adequately provided accruals for additional income taxes and related interest expense which may ultimately result from such examinations and we believe that the ultimate disposition of all such examinations should not have a material adverse effect on our consolidated financial position,

results of operations or liquidity.

We are a party to a tax sharing agreement with Contran and NL providing for the allocation of tax liabilities and tax payments as described in Note 1. Under applicable law, we, as well as every other member of the Contran Tax Group, are each jointly and severally liable for the aggregate federal income tax liability of Contran and the other companies included in the Contran Tax Group for all periods in which we are included in the Contran

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Tax Group. NL has agreed, however, to indemnify us for any liability for income taxes of the Contran Tax Group in excess of our tax liability in accordance with the tax sharing agreement.

Concentration of credit risk. Our products are sold primarily in North America to original equipment manufacturers. Our ten largest customers accounted for approximately 46% of sales in 2016 and 44% in each of 2017 and 2018. One customer of the Security Products segment accounted for 14% of consolidated sales in 2016, 16% in 2017 and 13% in 2018. Another customer of the Security Products segment accounted for approximately 11% of consolidated sales in 2016.

Rent expense was approximately \$0.2 million in each of 2016 and 2017 and \$0.1 million in 2018. At December 31, 2018, future minimum rentals under non-cancellable operating leases having an initial or remaining term of more than one year were as follows:

| Years ending December 31, | Amount (In thousands) |
|---------------------------|--------------------------|
| 2019 | \$113 |
| 2020 | 109 |
| 2021 | 53 |
| 2022 | - |
| 2023 | - |
| 2024 and thereafter | - |
| Total | \$275 |

Note 11 – Financial instruments:

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

| | December 31, 2017 | | December 31, 2018 | |
|---------------------------|----------------------|---------------|----------------------|---------------|
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Cash and cash equivalents | \$29,655 | \$29,655 | \$45,414 | \$45,414 |
| Accounts receivable, net | 10,446 | 10,446 | 12,140 | 12,140 |
| Accounts payable | 2,272 | 2,272 | 3,236 | 3,236 |

Due to their near-term maturities, the carrying amounts of accounts receivable and accounts payable are considered equivalent to fair value.

Note 12 – Recent Accounting Pronouncements:

Adopted

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) for all contracts which were not completed as of January 1, 2018 using the modified retrospective method. Prior to adoption

of this standard, we recorded sales when our products were shipped and title and other risks and rewards of ownership had passed to our customer, which was generally at the time of shipment (although in some instances shipping terms were FOB destination point, for which we did not recognize revenue until the product was received by our customer). Following adoption of this standard, we record sales when we satisfy our performance obligations to our customers by transferring control of our products to them, which we have determined is at the same point in time that we recognized revenue prior to adoption of this new standard. Accordingly, the adoption of Topic 606 as of January 1, 2018 did not have a material impact on our consolidated financial statements, and we believe adoption of this standard will have a minimal effect on our revenues on an ongoing basis. See Note 1.

Pending Adoption

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which is a comprehensive rewriting of the lease accounting guidance which aims to increase comparability and transparency with regard to lease transactions. The primary change for leases currently classified as operating leases is the balance sheet recognition of a lease asset for the right to use the underlying asset and a lease liability for the lessee's obligation to make payments. The ASU, as amended, also requires increased qualitative disclosure about leases in addition to quantitative disclosures currently required. We will adopt ASU 2016-02 beginning in the first quarter of 2019. Due to our minimal utilization of lease financing, we have concluded that the adoption of this standard will not have a material effect on our consolidated financial statements.

Note 13 – Quarterly results of operations (unaudited):

| | Quarter ended | | | |
|--------------------------------------|---|---------|----------|---------|
| | March 31 | June 30 | Sept. 30 | Dec. 31 |
| | (In millions, except per share amounts) | | | |
| 2017: | | | | |
| Net sales | \$29.9 | \$ 30.0 | \$ 27.0 | \$ 25.1 |
| Gross profit | 9.7 | 9.5 | 8.2 | 7.4 |
| Operating income | 4.5 | 4.6 | 3.4 | 2.7 |
| Net income | 3.2 | 3.3 | 2.5 | 4.3 |
| Basic and diluted earnings per share | \$.25 | \$.27 | \$.20 | \$.34 |
| 2018: | | | | |
| Net sales | \$28.4 | \$ 32.4 | \$ 30.0 | \$ 27.4 |
| Gross profit | 9.5 | 11.2 | 9.6 | 7.9 |
| Operating income | 4.4 | 6.0 | 4.5 | 2.9 |
| Net income | 3.7 | 5.0 | 3.9 | 2.7 |
| Basic and diluted earnings per share | \$.30 | \$.40 | \$.32 | \$.22 |

During the fourth quarter of 2017, we recognized a non-cash deferred income tax benefit of \$1.9 million related to the revaluation of our net deferred income tax liability resulting from the reduction in the U.S. federal corporate income tax rate enacted into law on December 22, 2017 (see Note 7). The sum of the quarterly per share amounts may not equal the annual per share amounts due to relative changes in the weighted-average number of shares used in the per share computations.