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## Screening Process

CompX International (CIX) meets the majority of the screening criteria and appears to be potentially undervalued. CIX's market cap of $164 million is below threshold for US companies, and their P/E and M/B ratios of 12.4x and 1.2x fall under the cut off for value stocks. With regards to unpopularity, CIX is a simple business with no analyst coverage and low growth. The business involves minimal technology, has limited exposure to commodities, and has a corporate structure that is simple, but highly hierarchal with numerous parent companies. Dividends, occasional share buybacks and no use of stock options are also attractive. However, the entire management team hold less than 2% of shares of CIX, which results in incentive misalignment and is a red flag.

## Business and Financial Risk:

CIX is a player in the US security and marine parts industries. The security industry in the US is highly competitive, mature, and has significant barriers to entry. The marine component manufacturing industry is more fragmented and competition comes from smaller domestic players with minimal foreign competition. Despite the competitive nature of these industries, CIX has maintained a stable operating margin of 12.8% over the past 5 years (Exhibit 1). In the North American market, CIX has differentiated itself with patented, design-oriented products with high margins. CIX has diversified their product and customer base through two distinct segments, allowing them to lower risk, offer different price points and appeal to a larger target market. Furthermore, end consumers represent the middle-high end segments who are less price sensitive. CIX has limited exposure to commodity markets, as zinc, brass, and steel make up 11% of cost of goods sold. However, CIX hedges this cost volatility through short-term commodity-related contracts. Overall, CIX has **medium business risk**.

CIX's target B/V is 0.3%, which is significantly lower than the optimal range of 30-49% for medium business risk companies (Exhibits 2, 3). As such, CIX has **low financial risk**. Analysis of financial ratios suggest CIX should be rated at AAA (Exhibit 4), also placing them at the lower tier of financial risk. Despite the ratios, a AA rating was given as this is the lowest possible rating for medium business risk companies. Altogether, this leads to an ERP of 4%, Kd of 3.58%, Ks of 7.58%, and WACC of 7.56% (Exhibit 5).

## NAV and EPV Valuation

CIX is valued at $19.09 per share using the NAV method (Exhibit 7). For the product portfolio, industry peers have allocated 1.0% of sales to R&D, which was assumed to result in a product lifecycle of 10 years (Exhibit 10). Customer relations (Exhibit 9) was assigned a 2.0x multiplier as CIX manufactures customizable and differentiated products. Regarding CIX's PPE (Exhibit 8) a multiple of 0.9x was assigned to equipment since CIX competes in mature industries with little technological innovation, and the book value of construction in progress was used to be conservative.

EPV gives a price/share of $16.37 (Exhibit 11). This was calculated using a 5-year average clean operating margin of 13.5%. Also, a 10-year OTA average of 1.23% implies an OTA charge of $1.37M (Exhibit 12). Normalized zero growth FCF was calculated as $10.2M (Exhibit 13). CIX's first pass ROIC of 14.1% is higher than WACC, but second pass ROIC of 4.87% is lower than WACC, as a result of hidden assets, reinforcing that NAV is greater than EPV and that there is no franchise value (Exhibits 6, 15).

## Strategic Analysis

Scott James was promoted internally to CEO on May 24, 2017, and took over for David Bowers, the former CEO of 12 years. James has previously served as the Chairman and COO for 3 years, and was the Vice-President in charge of the security segment (segmental margin expanded from 15% to 20% under his management). James seems to be doing a better job at managing the company (no asset write-downs or goodwill impairments thus far), however the lack of insider ownership, under levered balance sheet, and willingness to operate in unrelated segments are cause for concern. Therefore, the probability of **management** as a catalyst is medium. ROIC decomposition indicates that CIX has high excess capacity, specifically within the Marine Components segment (Exhibit 16). The cyclical Marine Components segment dampens the Company's operating margin, asset turnover and overall ROIC, resulting in a medium probability of **excess capacity**. Lastly, CIX benefits from a **competitive advantage** for products within the Security Products segment given established relationships, patents, specialized products, and most importantly, economies of scale. However, the company may have a **competitive disadvantage** in the Marine Components segment given commodity exposure, inability to pass costs to customers, and the lack of economies of scale.

Although the analysis implies a catalyst probability around 50%, the actual probability is **low (20%)** due to the private 87% ownership, which reduces the probability of any changes that would unlock value and bring EPV closer to NAV.

## Recommendation

CIX's intrinsic value is $16.92/share. After a 33% margin of safety, the implied entry price is $11.28, while the current share price is $12.85. As such, we recommend **waiting to buy CIX** (Exhibit 17).