

COMPX INTERNATIONAL INC
Form 10-Q
May 07, 2018

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarter ended March 31, 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.)
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5430 LBJ Freeway, Suite 1700,

Three Lincoln Centre, Dallas, Texas (Address of principal executive offices)	75240-2620 (Zip Code)
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Registrant's telephone number, including area code (972) 448-1400

Indicate by checkmark:

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

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

Whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See 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 (Do not check if a smaller reporting company)

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 .

Number of shares of common stock outstanding on May 2, 2018:

Class A: 2,426,107 Class B: 10,000,000

COMPX INTERNATIONAL INC.

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COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	December 31, 2017	March 31, 2018
ASSETS		(unaudited)
Current assets:		
Cash and cash equivalents	\$ 29,655	\$ 28,353
Accounts receivable, net	10,446	12,673
Inventories, net	15,382	16,328
Prepaid expenses and other	879	739
Total current assets	56,362	58,093
Other assets:		
Note receivable from affiliate	38,200	38,000
Goodwill	23,742	23,742
Other noncurrent	590	590
Total other assets	62,532	62,332
Property and equipment:		
Land	4,935	4,935
Buildings	22,774	22,774
Equipment	67,373	67,712
Construction in progress	569	850
	95,651	96,271
Less accumulated depreciation	63,586	64,385
Net property and equipment	32,065	31,886
Total assets	\$ 150,959	\$ 152,311
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 10,792	\$ 8,430
Income taxes payable to affiliates	470	923
Total current liabilities	11,262	9,353
Noncurrent liabilities -		
Deferred income taxes	3,112	3,268
Stockholders' equity:		
Preferred stock	—	—
Class A common stock	24	24
Class B common stock	100	100
Additional paid-in capital	55,612	55,612
Retained earnings	80,849	83,954
Total stockholders' equity	136,585	139,690
Total liabilities and stockholders' equity	\$ 150,959	\$ 152,311

Commitments and contingencies (Note 1)

See accompanying Notes to Condensed Consolidated Financial Statements.

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COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

	Three months ended March 31, 2017 2018 (unaudited)	
Net sales	\$29,948	\$28,413
Cost of goods sold	20,262	18,910
Gross profit	9,686	9,503
Selling, general and administrative expense	5,162	5,130
Operating income	4,524	4,373
Interest income	335	572
Income before taxes	4,859	4,945
Provision for income taxes	1,708	1,219
Net income	\$3,151	\$3,726
Basic and diluted net income per common share	\$0.25	\$0.30
Cash dividends per share	\$0.05	\$0.05
Basic and diluted weighted average shares outstanding	12,419	12,426

See accompanying Notes to Condensed Consolidated Financial Statements.

COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three months ended March 31,	
	2017	2018
	(unaudited)	
Cash flows from operating activities:		
Net income	\$3,151	\$3,726
Depreciation and amortization	915	878
Deferred income taxes	37	157
Other, net	14	42
Change in assets and liabilities:		
Accounts receivable, net	(2,644)	(2,235)
Inventories, net	(381)	(980)
Accounts payable and accrued liabilities	(2,303)	(2,418)
Accounts with affiliates	1,079	453
Prepays and other, net	(78)	140
Net cash used in operating activities	(210)	(237)
Cash flows from investing activities:		
Capital expenditures	(609)	(644)
Note receivable from affiliate:		
Collections	12,500	12,600
Advances	(14,100)	(12,400)
Net cash used in investing activities	(2,209)	(444)
Cash flows from financing activities -		
Dividends paid	(621)	(621)
Cash and cash equivalents - net change from:		
Operating, investing and financing activities	(3,040)	(1,302)
Balance at beginning of period	33,153	29,655
Balance at end of period	\$30,113	\$28,353
Supplemental disclosures -		
Cash paid for income taxes	\$585	\$602

See accompanying Notes to Condensed Consolidated Financial Statements.

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COMPX INTERNATIONAL INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Three months ended March 31, 2018

(In thousands)

(unaudited)

	Common stock Class Class		Additional paid-in capital	Retained earnings	Total stockholders' equity
	A	B			
Balance at December 31, 2017	\$24	\$100	\$ 55,612	\$80,849	\$ 136,585
Net income	—	—	—	3,726	3,726
Cash dividends	—	—	—	(621)	(621)
Balance at March 31, 2018	\$24	\$100	\$ 55,612	\$83,954	\$ 139,690

See accompanying Notes to Condensed Consolidated Financial Statements.

COMPX INTERNATIONAL INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2018

(unaudited)

Note 1 – Organization and basis of presentation:

Organization. We (NYSE American: CIX) are 87% owned by NL Industries, Inc. (NYSE: NL) at March 31, 2018. We manufacture and sell component products (security products and recreational marine components). At March 31, 2018, Valhi, Inc. (NYSE: VHI) owns 83% of NL's outstanding common stock and a wholly-owned subsidiary of Contran Corporation owns 93% 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.

Basis of presentation. Consolidated in this Quarterly Report are the results of CompX International Inc. and its subsidiaries. The unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report have been prepared on the same basis as the audited Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 that we filed with the Securities and Exchange Commission ("SEC") on February 28, 2018 (the "2017 Annual Report"). In our opinion, we have made all necessary adjustments (which include only normal recurring adjustments) in order to state fairly, in all material respects, our consolidated financial position, results of operations and cash flows as of the dates and for the periods presented. We have condensed the Consolidated Balance Sheet at December 31, 2017 contained in this Quarterly Report as compared to our audited Consolidated Financial Statements at that date, and we have omitted certain information and footnote disclosures (including those related to the Consolidated Balance Sheet at December 31, 2017) normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Our results of operations for the interim period ended March 31, 2018 may not be indicative of our operating results for the full year. The Condensed Consolidated Financial Statements contained in this Quarterly Report should be read in conjunction with our 2017 Consolidated Financial Statements contained in our 2017 Annual Report.

Our operations are reported on a 52 or 53-week year. For presentation purposes, annual and quarterly information in the Condensed Consolidated Financial Statements and accompanying notes are presented as ended March 31, 2017, December 31, 2017 and March 31, 2018. The actual dates of our annual and quarterly periods are April 2, 2017, December 31, 2017 and April 1, 2018, respectively. Unless otherwise indicated, references in this report to "we", "us" or "our" refer to CompX International Inc. and its subsidiaries, taken as a whole.

Note 2 – Business segment information:

Three months
ended
March 31,

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	2017	2018
	(In thousands)	
Net sales:		
Security Products	\$26,010	\$24,056
Marine Components	3,938	4,357
Total net sales	\$29,948	\$28,413
Operating income (loss):		
Security Products	\$5,691	\$5,612
Marine Components	371	586
Corporate operating expenses	(1,538)	(1,825)
Total operating income	4,524	4,373
Interest income	335	572
Income before taxes	\$4,859	\$4,945

Intersegment sales are not material.

Note 3 – Accounts receivable, net:

	December 31, 2017	March 31, 2018
	(In thousands)	
Accounts receivable, net:		
Security Products	\$9,341	\$10,836
Marine Components	1,175	1,909
Allowance for doubtful accounts	(70)	(72)
Total accounts receivable, net	\$10,446	\$12,673

Note 4 – Inventories, net:

	December 31, 2017	March 31, 2018
	(In thousands)	
Raw materials:		
Security Products	\$2,156	\$2,174
Marine Components	574	596
Total raw materials	2,730	2,770
Work-in-process:		
Security Products	8,290	8,954
Marine Components	1,546	1,713
Total work-in-process	9,836	10,667
Finished goods:		
Security Products	2,079	2,148
Marine Components	737	743
Total finished goods	2,816	2,891
Total inventories, net	\$15,382	\$16,328

Note 5 – Accounts payable and accrued liabilities:

	December 31, 2017	March 31, 2018
	(In thousands)	
Accounts payable:		
Security Products	\$1,897	\$2,275
Marine Components	375	\$494

Accrued liabilities:		
Employee benefits	7,413	4,008
Customer tooling	290	319
Taxes other than on income	289	504
Other	528	830
Total accounts payable and accrued liabilities	\$10,792	\$8,430

Note 6 – Revenue Recognition

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 10), 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.

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.

Note 7 – Provision for income taxes:

	Three months ended March 31, 2017 2018 (In thousands)	
Expected tax expense, at the U.S. federal statutory		
income tax rate of 35% in 2017 and 21% in 2018	\$1,701	\$1,038
Domestic production activities deduction	(145)	-
State income taxes	132	172

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Other, net	20	9
Total income tax expense	\$1,708	\$1,219

As discussed in the 2017 Annual Report, on December 22, 2017, H.R.1, formally known as the “Tax Cuts and Jobs Act” (“2017 Tax Act”) was enacted into law. This new tax legislation, among other changes, reduced the U.S. Federal corporate income tax rate from 35% to 21% effective January 1, 2018. 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 states that companies should account for changes related to the 2017 Tax Act in the period of enactment if all information is available and the accounting can be completed. In situations where companies do not have enough information to complete the accounting in the period of enactment, a company must either 1) record an estimated provisional amount if the impact of the change can be reasonably estimated; or 2) continue to apply the accounting guidance that was in effect immediately prior to the 2017 Tax Act if the impact of the change cannot be reasonably estimated. If estimated provisional amounts are recorded, SAB 118 provides a measurement period of no longer than one year during which companies should adjust those amounts as additional information becomes available.

Under GAAP, we are required to revalue our net deferred tax liability associated with our U.S. net taxable temporary differences in the period in which the new tax legislation is enacted based on deferred tax balances as of the enactment date, to reflect the effect of such 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 \$1.9 million recognized as of December 31, 2017 in continuing operations, reducing our net deferred income tax liability. The new tax legislation also eliminated the domestic production activities deduction beginning in 2018 and allows for the expensing of certain capital expenditures for assets placed in service between September 28, 2017 and December 31, 2022. The amounts recorded as of December 31, 2017 as a result of the 2017 Tax Act represent estimates based on information currently available. We

have not made any additional measurement-period adjustments to the provisional amounts recorded for this item during the first quarter of 2018 because we are still waiting on additional guidance that may impact the income tax effects of the new legislation recognized at December 31, 2017. We will complete our accounting for this item within the prescribed measurement period ending December 22, 2018, pursuant to the guidance under SAB 118, and if we determine an adjustment to the provisional amount recognized at December 31, 2017 is required, we will recognize such adjustment in the reporting period within the SAB 118 measurement period in which such adjustment is determined.

Note 8 – Financial instruments:

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

	December 31, 2017		March 31, 2018	
	Carrying amount	Fair value	Carrying amount	Fair value
	(In thousands)			
Cash and cash equivalents	\$29,655	\$29,655	\$28,353	\$28,353
Accounts receivable, net	10,446	10,446	12,673	12,673
Accounts payable	2,272	2,272	2,769	2,769

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

Note 9 – Related party transactions:

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, and when we borrow from related parties, we are generally able to pay a lower rate of interest than we would pay if we had incurred third-party indebtedness. While certain of these loans to affiliates may be of a lesser credit quality than cash equivalent instruments otherwise available to us, we believe we have considered the credit risks in the terms of the applicable loans. In this regard, we have an unsecured revolving demand promissory note with Valhi whereby we 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, 2019. Loans made to Valhi at any time under the agreement are at our discretion. At March 31, 2018, the outstanding principal balance receivable from Valhi under the promissory note was \$38.0 million. Interest income (including unused commitment fees) on our loan to Valhi was \$0.3 million and \$0.5 million for the three months ended March 31, 2017 and 2018, respectively.

Note 10 – 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 6.

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 will be the recognition of lease assets for the right-of-use of the underlying asset and lease liabilities for the obligation to make payments by lessees on the balance sheet for leases currently classified as operating leases. The ASU also requires increased qualitative disclosure about leases in addition to quantitative disclosures currently required. Companies are required to use a modified retrospective approach to adoption with a practical expedient which will allow companies to continue to account for existing leases under the prior guidance unless a lease is modified, other than the requirement to recognize the right-of-use asset and lease liability for all operating leases. The changes indicated above will be effective for us beginning in the first quarter of 2019, with early adoption permitted. We have not yet evaluated the effect this ASU will have on our Consolidated Financial Statements, but given the amount of our future minimum payments under non-cancellable operating leases at December 31, 2017 totaling \$0.4 million, we do not expect the adoption of this standard to have a material effect on our Consolidated Balance Sheet.

ITEM 2. 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 electronic 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 and trim tabs for the recreational marine and other industries through our Marine Components segment.

General

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, as amended. Statements in this Quarterly 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 Quarterly Report and those described from time to time in our other filings with 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, aluminum, steel 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 product features,
- Future litigation,
- 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.

Operations Overview

We reported operating income of \$4.4 million in the first quarter of 2018 compared to \$4.5 million in the same period of 2017. The decrease in operating income from 2017 to 2018 primarily resulted from lower Security Products sales.

Our product offerings consist of a significantly 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.

Results of Operations

	Three months ended			
	March 31,			
	2017	%	2018	%
	(Dollars in thousands)			
Net sales	\$29,948	100.0%	\$28,413	100.0%
Cost of goods sold	20,262	67.7 %	18,910	66.6 %
Gross profit	9,686	32.3 %		