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Compass Diversified NYSE:CODI

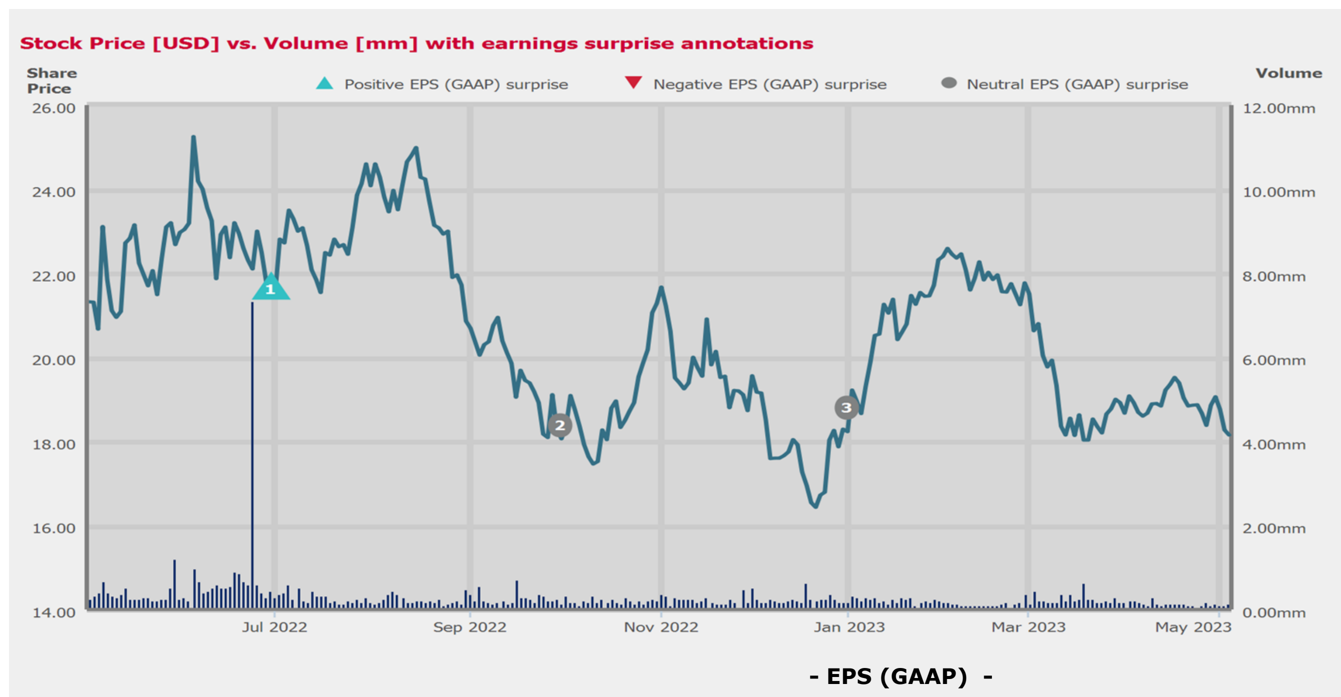
FQ1 2023 Earnings Call Transcripts

Wednesday, May 03, 2023 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FQ2 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	(0.02)	-	NM	0.02	0.27	0.84
Revenue (mm)	541.50	542.23	▲0.13	556.15	2324.18	2509.91

Currency: USD
Consensus as of Apr-13-2023 5:06 AM GMT



- EPS (GAAP) -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2022	0.11	0.38	▲245.45 %
FQ3 2022	0.10	(0.21)	NM
FQ4 2022	0.06	(0.17)	NM
FQ1 2023	(0.02)	-	NM

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Cody Slach
Gateway Group, Inc.

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Presentation

Operator

Good afternoon, and welcome to Compass Diversified's First Quarter 2023 Conference call. Today's call is being recorded. [Operator Instructions]

At this time, I would like to turn the conference over to Cody Slach of Gateway Group for introductions and the reading of the safe harbor statement. Please go ahead, sir.

Cody Slach
Gateway Group, Inc.

Thank you, and welcome to Compass Diversified's First Quarter 2023 Conference Call. Representing the company today are Elias Sabo, CODI's CEO; Ryan Faulkingham, CODI's CFO; and Pat Maciariello, COO of Compass Group Management.

Before we begin, I would like to point out that the Q1 2023 press release, including the financial tables and non-GAAP financial measure reconciliations for adjusted EBITDA, adjusted earnings and pro forma net sales are available at the Investor Relations section on the company's website at compassdiversified.com.

The company also filed its Form 10-Q with the SEC today after the market closed, which includes reconciliations of certain non-GAAP financial measures discussed on this call and is also available at the Investor Relations section of the company's website.

Please note that references to EBITDA and the following discussions refer to adjusted EBITDA as reconciled to net income or loss from continuing operations in the company's financial filings. The company does not provide a reconciliation of its full year expected 2023 adjusted earnings or adjusted EBITDA because certain significant reconciling information is not available without unreasonable efforts. Throughout this call, we will refer to Compass Diversified as CODI or the company.

Now allow me to read the following safe harbor statement. During this call, we may make certain forward-looking statements, including statements with regard to the future performance of CODI and its subsidiaries, the impact and expected timing of acquisitions and future operational plans such as ESG initiatives. Words such as believes, expects, anticipates, plans, projects and future or similar expressions are intended to identify forward-looking statements.

These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions. Certain factors could cause actual results to differ on a material basis from those projected in these forward-looking statements, and some of these factors are enumerated in the risk factor discussion in the Form 10-K as filed with the SEC for the year ended December 31, 2022, as well as in other SEC filings.

In particular, the domestic and global economic environment, supply chain, labor disruptions, inflation, and rising interest rates all may have a significant impact on CODI and our subsidiary companies. Except as required by law, CODI undertakes no obligation to publicly update or revise any forward-looking statements whether as a result of new information, future events or otherwise.

At this time, I would like to turn the call over to Elias Sabo.

Elias Joseph Sabo
Partner, CEO & Director

Good afternoon, everyone, and thanks for joining us today. We are pleased to report financial results that significantly exceeded our expectations. The strength and durability of our diversified group of subsidiaries was evidenced again in the first quarter as we delivered growth in both revenue and consolidated subsidiary adjusted EBITDA on a pro forma basis. This is an extraordinary accomplishment amidst the

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backdrop of broad and unique macroeconomic challenges. And as a result, we are raising our full year outlook for both subsidiary adjusted EBITDA and adjusted earnings.

I think the obvious question is how are we able to achieve this. Well, it's no different than what we've said in the past, but perhaps this quarter, it's more apparent. Our strategy of assembling a highly-diversified group of companies that reach a broad set of end markets, reach a wide set of consumer demographics and have a strong underlying core growth rate drove the results we reported today. This is highly intentional and can be traced back to 2018 when we made a concerted strategic shift to transform our business towards higher-quality, higher-growth assets. I'd like to recognize our amazing group of companies and colleagues for allowing us to deliver these strong results today.

But despite this, the headwinds we overcame in Q1 are still very much out there and cloud our near-term outlook. Similar to our remarks on our fourth quarter call, some of our branded consumer subsidiaries with exposure to wholesale continue to experience significant inventory destocking headwinds. As a reminder, in the first half of 2022, we benefited from extremely high demand from customers who needed our product to help manage their own supply chain issues. With the pandemic winding down and some retailers reckoning with the fact that they over-ordered, it has created a whipsaw effect until inventory is rightsized. Until this happens, our growth in these businesses will be constrained. But fortunately, it is a unique event that we expect to start correcting in the second half of the year.

Take BOA, for example. This subsidiary is executing at an extremely high level and continues to take market share. Our products are on some of the strongest selling SKUs for our brand partners, and we continue to accelerate the number of new SKUs we are gaining placement on, but the current rate of destocking is so high that it's actually outpacing the market share gains we are experiencing from product sell-through and SKU count growth. This is obviously a unique phenomenon. And once we get beyond this current inventory destocking cycle, we would expect a significant snapback in revenue growth and profitability.

We are also seeing the same broad trends at PrimaLoft given its similar position in the supply chain. Taking together with BOA, these represent 2 of our strongest and fastest-growing businesses. They represent our businesses with some of the best value propositions, competitive differentiation, margins and free cash flow generation. So the fact that they're getting pulled down by an unusual phenomenon, and we are still reporting consolidated growth, ties back to the incredible performance our diversified business model facilitates.

Outside of these 2 subsidiaries, we delivered an astounding 15% organic growth in adjusted EBITDA. The majority of our remaining subsidiaries are performing extremely well. This gives us confidence that once the inventory destocking headwinds subside with BOA and PrimaLoft reverting back to normalized growth rates that our overall business will again show strong growth.

Before turning the call over to Pat, I'd like to summarize our performance and outlook. While we had an outstanding first quarter that was stronger than anticipated, we expect the negative effects of inventory destocking and other market headwinds to suppress earnings in Q2. End demand for the majority of our goods and services remain strong. However, we experienced some moderation in end market sales as the quarter progressed, and April has continued that trend. Notwithstanding a modest slowing, the most affluent consumer continues to spend as evidenced by the incredible performance at Lugano. And as you are aware, we sell the majority of our goods at our consumer businesses to the more affluent consumer, which positions us well during this time of economic uncertainty.

Notwithstanding the headwinds we expect to encounter in Q2, the strength of our subsidiaries gives us confidence we will deliver growth in the second half of 2023, leading to growth for the full year.

With that, I will now turn the call over to Pat.

Patrick A. Maciariello
Partner & COO

Thanks, Elias. Throughout this presentation when we discuss pro forma results, it will be as if we owned PrimaLoft from January 1, 2022. On a combined basis, revenue and EBITDA grew slightly and exceeded

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our expectations. As Elias discussed, the widely-reported supply chain disruptions in 2021 and 2022 created elevated inventory levels in multiple areas and, in the quarter, led to order patterns that often differed materially from end customer demand. Despite this challenging backdrop, our management teams and employees continue to perform with agility and skill.

Now on to our subsidiary results. I'll begin with our niche industrial businesses. For the first quarter of 2023, revenues were approximately flat and adjusted EBITDA increased by 19% versus the first quarter of 2022. Each of our niche industrial businesses expanded margins in the quarter and, in aggregate, adjusted EBITDA margins expanded by over 250 basis points.

In the first quarter, Arnold showed solid growth in revenue and EBITDA, and bookings once again exceeded shipments. Margins expanded partially due to more positive sales mix as the company continues to provide more technologically advanced solutions to their customers.

Outdoor's revenue declined slightly in the quarter, as some of its more cyclical end markets faced headwinds. Adjusted EBITDA increased by almost 11%, however, as raw material prices declined and management continued to work to gain efficiencies. As a reminder, Terry Moody, Outdoor's CEO, led a planned management transition a bit less than a year ago, and we are very pleased by the early progress made by him and his team.

At Sterno, demand for catering products continued to revert back to pre-pandemic levels, driving growth in the company's foodservice segment. Sterno's scented wax and oil business continued its solid performance as well, and costs at the combined business were well managed in the quarter.

Turning to our consumer businesses. For the first quarter of 2023, revenues increased by 2%, and adjusted EBITDA declined by 5% as excess inventory in the supply chains at BOA, PrimaLoft and Velocity, offset strong growth at Lugano, Marucci and 5.11. Though BOA showed a decline in EBITDA versus a record Q1 2022, we remain very confident in the company's market share, SKU counts and product positioning. Put simply, in many segments, our sell-in was less than our sell-through. As we have discussed, we believe this trend will continue in the second quarter before rebounding in the back half of the calendar year. The team there continues to manage effectively, and we continue to expect full year 2023 EBITDA performance above 2021 levels.

We were encouraged recently by the prelaunch of Alpine boots, incorporating, BOA's technology as well as the company's partnership with Under Armour on their new slip speed line of training shoes.

Marucci had an exceptional quarter as revenue grew by 12% and EBITDA grew by over 25% when compared to the strong Q1 2022. The company benefited from exceptional sell-throughs of its CATX line of bats introduced last year and experienced strong growth in non-bat categories, including fielding gloves, bags and helmets, all showing significant growth in the quarter. Also significant air freight investments incurred in Q1 2022 to maintain and grow shelf space did not recur in Q1 2023, and the company operated efficiently.

Lugano once again had a strong quarter as revenues, and adjusted EBITDA grew by 36% and 38%, respectively. The company saw strong growth in multiple salons, including Newport Beach, Palm Beach and its newly-opened Houston salon. Subsequent to quarter end, Lugano officially opened its Washington, D.C. salon, along with its exclusive Privé membership club and Newport Beach. The company is currently building out its Greenwich, Connecticut location with a target completion date in the third quarter of this year. Lugano was also targeting a second flagship location, similar to the company's Newport Beach salon, and potentially its first international salon in early 2024.

Similar to Lugano, 5.11 had a strong first quarter, with revenue and adjusted EBITDA growing by 20% and 22%, respectively. Despite broad retail pressures in the U.S., the company once again benefited from strength in its diverse sales channels and end markets as professional sales, both domestically and internationally, led its growth. Additionally, the team at 5.11 did an excellent job in the quarter, operating effectively and efficiently, and we're able to gain leverage as adjusted EBITDA growth outpaced revenue growth.

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PrimaLoft showed a slight decline in both revenue and EBITDA as customers continue to pull down their target inventory levels. While financial performance to date has not fully met our expectations at the time of acquisition, we believe the company is taking market share. And given where it sits in the supply chain and the impact of inventory rebalancing, we believe it is outperforming its competitors. The company's project pipeline for 2024 is as broad as ever, and we remain bullish about PrimaLoft's financial prospects, following inventory stabilization in the supply chain.

Touching briefly on Velocity. Point-of-sale activity has slowed following strong performance during and immediately post-pandemic. In addition, retail partners in both of the company segments have sought to further reduce inventory levels. Though it is our belief that on a sequential basis, quarterly performance will improve as we move through the year, we continue to examine additional options to rightsize parts of Velocity's cost structure to better reflect current demand patterns. As a whole, we were very pleased with the performance of our businesses in the first quarter.

I will now turn the call over to Ryan for his comments on our financial results.

Ryan J. Faulkingham
Executive VP, CFO & Co-Compliance Officer

Thank you, Pat. Moving to our consolidated financial results for the quarter ended March 31, 2023. I will limit my comments largely to the overall results for CODI since the individual subsidiary results are detailed in our Form 10-Q that was filed with the SEC earlier today.

As a reminder, our sale of Advanced Circuits occurred in the first quarter of 2023 and, therefore, was reclassified to discontinued operations in our first quarter 10-Q.

Now to our quarterly consolidated results. On a consolidated basis, revenue for the quarter ended March 31, 2023, was $542.2 million, up 6% compared to $510.5 million for the prior year period. This year-over-year increase primarily reflects our acquisition of PrimaLoft during the third quarter of 2022. Consolidated net income for the first quarter was $109.6 million compared to net income of $29.7 million in the prior year. The increase was primarily due to the $98 million gain on the sale of Advanced Circuits in the first quarter, offset by an increase in interest expense as a result of financing the PrimaLoft acquisition and rising interest rates.

Adjusted EBITDA in the first quarter was $91.9 million, up 11% compared to $83.2 million in the first quarter of last year. The increase was due to the benefit of the PrimaLoft acquisition. Adjusted earnings for the first quarter was above our expectations at $33.2 million, down from $36 million in the prior year quarter. The decline was primarily a result of higher interest expense.

Now on to our financial outlook. As a result of the strong performance in the first quarter relative to our expectations, we are increasing our adjusted EBITDA and adjusted earnings estimates. For the full year 2023, we expect consolidated subsidiary adjusted EBITDA to range between $430 million and $460 million, an increase of $10 million at the bottom end of our initial range. For the full year 2023, we expect adjusted earnings to range between $110 million and $135 million, an increase of $5 million at the bottom end of our initial range. As Elias and Pat have covered, this outlook expects a challenging second quarter given the headwinds discussed and assumes a mid-single-digit percentage decline in adjusted EBITDA sequentially and then a reacceleration in the second half of the year.

Turning to our balance sheet. As of March 31, 2023, we had approximately $53.7 million in cash, approximately $590 million available on our revolver, and our leverage was 3.87x. We have substantial liquidity. And as previously communicated, we have the ability to upsize our revolver capacity by an additional $250 million. During the quarter, we used the net proceeds from the sale of Advanced Circuits to repay our leverage -- our revolver balance, therefore, reducing our leverage levels.

In addition, subsequent to quarter end, we used approximately $20 million to fund Marucci's add-on acquisition of Baum Bat. With our liquidity and capital, we stand ready and able to provide our subsidiaries with the financial support they need, invest in subsidiary growth opportunities and act on compelling acquisition opportunities as they present themselves.

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Turning now to cash flow provided by operations. During the first quarter of 2023, we received $15.5 million of cash flow from operations, primarily a result of strong operating performance. We used $31.5 million in working capital during the first quarter of 2023, a substantial decrease from $95.7 million in the prior year quarter when we needed to support many of our businesses' inventory levels as a result of supply chain disruptions. Lugano will continue to require working capital investments However, we expect to produce strong consolidated cash conversion in 2023 for our remaining subsidiaries in total.

Also of note during the quarter, the manager waived 50% of the management fee owed by the company in respect to PrimaLoft.

And finally, turning to CapEx. During the first quarter of 2023, we incurred $16.1 million of capital expenditures at our existing subsidiaries compared to $10.4 million in the prior year period. The increase was primarily a result of the timing of retail build-outs at Lugano and 5.11 to support their continued growth. For the full year of 2023, we anticipate total CapEx spend of between $60 million and $70 million. We continue to see strong returns on invested capital at several of our growth subsidiaries and believe they will have short payback periods. The 2023 capital expenditure spend will primarily be at Lugano for new retail salons and at 5.11 as we continue to increase its retail store count from its current 118 stores.

With that, I will now turn the call back over to Elias.

Elias Joseph Sabo
Partner, CEO & Director

Thank you, Ryan. I'd like to close by briefly providing an update on the M&A market and our strategic initiatives. In terms of M&A, not much has changed since we last spoke in March. Deal activity remained suppressed well below historic levels, and we continue to believe activity in the second half of 2023 will improve as economic headwinds moderate. On the ESG front, we continue to advance our key initiatives and execute our strategy. During the quarter, we had a variety of achievements throughout our organization that I would like to highlight.

Reflective of CODI's commitment to creating a positive impact for people and planet, we are thrilled to be awarded the silver badge from Catalyst 2030, an organization that partners with corporations to achieve the 2030 sustainable development goals outlined by the United Nations. We were awarded the silver badge in recognition of our work with social enterprises and the way we've actively used our purchasing power to partner with organizations with clearly defined social goals.

Looking at our companies. Last month, BOA released their annual sustainability and social responsibility impact report, which outlines their future goals to significantly reduce their carbon footprint and create a more inclusive environment with equitable opportunities.

Arnold Magnetic Technologies announced its partnership with Cyclic Materials, a pioneer in developing more sustainable domestic supply chains for rare earth elements. Arnold and Cyclic will work together to develop a rare earth recycling program, creating an unprecedented circular supply chain for rare earth materials.

I am proud of the progress CODI and our subsidiaries have made against our ESG framework, and we look forward to continuing on this path.

In conclusion, we're proud of our first quarter results, which are a testament to the successful execution of our strategy. The fact that we were able to generate organic growth in revenue and EBITDA amongst such a challenging operating environment speaks volumes to the quality of CODI's subsidiaries, the benefit of diversification amongst industries and the accelerated pace of our core growth rate.
With that, operator, please open up the lines for Q&A.

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Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Larry Solow from CGS Securities.

Lawrence Scott Solow
CJS Securities, Inc.

I guess just first, I guess, question on observation. So I feel like the year started off really strong, better than expected. Just trying to parse out the sort of the sequential -- a little bit of a drop mid-single digits, I guess, millions or percentage. Is it some acceleration in inventory, I guess a combination of more inventory drawdowns or more than you originally expected or longer than you originally expected into Q2 and some sort of a little bit of end market slowdown? And on the end market slowdown, are there particular businesses that are -- because it feels like most of the businesses, the larger ones are still doing strong outside inventory drawdown. So I'm just trying to get a little bit more color on where you're seeing a little bit of some extra end market slowdown.

Elias Joseph Sabo
Partner, CEO & Director

Yes. Larry, it's Elias, and thank you for the question. Q1 was a really good quarter for us. I think when we sat here couple of months ago when we talked about the first quarter on our fourth quarter earnings call, we had guided that we thought we might be down kind of high single digits to low double digits. And obviously, we performed significantly better than that, really almost across the board. The business -- BOA obviously had, as you see some of the weakness that we expected from kind of this inventory destocking, which is quite severe, and I would say that's continuing. But in general, our businesses performed really well.

Coming into Q2, I think we're just taking a more conservative and cautious outlook yet again in our guidance. It's weighing on us what we're hearing in terms of the macro environment out there. We're starting to see some of the data really weakening. Jolt came out down a couple -- I think it's at 2-year lows right now on kind of job openings. There's weakness in the regional banking sector. There's a bank down 40-plus percent in the aftermarket right now, and there's kind of just the continuing kind of rolling issues.

So we want to be more cautious, Larry. I would say, principally what you're hearing in terms of our outlook in Q2 is more us just being cautious and conservative. There is nothing that I would say is kind of materially slower. There may be a little bit of slowdown, for example, within the 5.11 DTC business that we're seeing, but it's not so material that we would get really nervous right now. I would say our industrial portfolio, which was seeing incredible bookings growth kind of in the first quarter, has now slowed to seeing pretty good bookings growth. So I would say there are some kind of evidence of a slight slowdown in new orders that are coming in. But on the other side, we're seeing some of the inflationary pressures come off, margins improve. I think you probably saw we had a massive improvement in margins within our industrial portfolio. We would expect that to continue.

So I would say that a lot of what we're forecasting here in the second quarter continues to be just an uneasiness that we all have about the macro headlines, but there is nothing right now in the business that I would say that points us to expect materially weaker results as we move forward.

And with respect to some of these inventory destocking headwinds, I think they're as we anticipated, and we anticipated that they were going to go at least through to the second quarter. I think that seems to be on schedule right now. There is some, I would say, green shoots that we see here and there, where we get a good bookings week that comes along. That's probably a little bit of an improvement of where we are, and we need to start seeing that in order to then get consistently good booking weeks at BOA and PrimaLoft, which is where most of the destocking issues are hitting the hardest.

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So I think in general, that feels to be on where we are. And as we sit today, Larry, we have a better kind of outlook and a higher kind of level of confidence in being able to achieve the annual numbers that we set out. But we are not immune to some of the headlines that we're all hearing right now, and we'd rather just be a bit conservative.

Lawrence Scott Solow
CJS Securities, Inc.

Yes, that's fair. I was going to ask you a question about Lugano, but maybe just on 5.11. So I know that, obviously, the businesses did remarkably well last couple of years through COVID and then where a lot of other power businesses last few quarters have really struggled and they continued to grow. Maybe you could just give us -- you mentioned DTC, which obviously has been the big growth driver. Is that still growing just a little bit slower? Maybe give us a little update there and just on new store opening plans for 5.11.

Patrick A. Maciariello
Partner & COO

Yes. So I'd say our DTC comps remain positive in Q1 of this year, and that's sort of all the color we typically give on comps, Larry. This is a Pat, by the way. But I think that's a positive sign.

A lot of the strength came from our professional business. Selling into law enforcement agencies was a very good business for the company in the first quarter. And again, unlike a lot of consumer brands out there, right, this diversified strategy really provides for consistency of earnings at 5.11, and that paid off.

As it relates to the new store, we have, call it, between 10 and 20 new stores planned to be opened this year, a little bit less than last year, but we are continuing to open them because the economics are just continue to be very compelling.

Lawrence Scott Solow
CJS Securities, Inc.

Got you. And if I could just slip one more, just on Lugano. Just obviously, the rapid growth there. I think you guys opened 2 new salons last year. Is the growth -- I feel like -- is the growth driven by the salon openings? There must be an optimal amount to, you can't just open wherever. So I am just trying to rein in and get a little more color on growth trajectory, which has been amazing going forward. I feel like it will flow. But any thoughts on that?

Patrick A. Maciariello
Partner & COO

Yes. The growth is partially driven by salon openings. It's also driven by increases in sort of average order size, which continues to increase materially, right? And so those -- and new customers, and we're adding a lot of new customers. And not all of those come from salons. Some of them may come from our equestrian operations, or they may come from other relationships and other events.

So I really can't -- it's not like 5.11, where you can point out our next stores times, this equals that, right? Like they -- it's a much more sort of complex picture there, so I can't give you a formula per se. But short answer is it's coming from everywhere.

Operator

Your next question comes from the line of Chris Kennedy from William Blair.

Cristopher David Kennedy
William Blair & Company L.L.C., Research Division

Elias, given what you just talked about on the macro side, talk about your confidence in the visibility for the snapback in the second half for BOA and PrimaLoft.

Elias Joseph Sabo

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Partner, CEO & Director

Yes, Chris, thanks for the question, and good afternoon. The -- I can't give you exact timing, right? And sort of Larry was kind of asking is it either deeper in terms of inventory kind of drawdown, or is it going longer, a little bit of that is going to be hard for us to tell. I think one of the things that impacted both BOA and PrimaLoft was really this kind of zero COVID policy out of China, and I know we're beyond that now. But if you just think about how many of our brand partners get a material amount of their sales in the greater China market and having kind of a number of months where Chinese consumers were on the sideline, it isn't just the product we sell to China-centric customers that then sell to the China market. It's brand partners globally that are sitting on significant inventory. Now with zero COVID being behind us, China reopening and consumption coming back, I think that's going to clear inventory and clear the way for us to be able to snap back.

I can't tell you whether it's Q3, Chris, or it's Q4. I think we're getting through this inventory overhang kind of faster and on a very accelerated basis. But I feel confident in the snapback, I just don't know when the timing is going to be. And we won't -- I won't give you specific numbers on how much. But I can tell you from our analysis, we think there is a dramatically higher amount of sell-through than there is sell-in. And so at some point, unless inventory goes to 0 in the supply chain, which is obviously not possible, at some point, we have to start to match our sell-through. And just given the delta between sell-in and sell-through right now, that will provide a material jump in revenue and profitability.

One, I think, that is probably far stronger than what any of us would be talking about, this isn't consistent with BOA's historical growth rate or PrimaLoft. Both of which have been north of 20% revenue growers over time. This is kind of a snapback that could be well in excess of that, given kind of the differential that exists right now between kind of sell-in and sell-through.

I also would point everyone to the fact that we do measure the amount of additional SKUs that were going on, and there has been no deceleration in the amount of SKU growth that we've had at both BOA and PrimaLoft. And so we are picking up massive amounts of share, which just add to the fact that the snapback is going to be, in our opinion, really violent in a good way. And when it happens, it's going to drive significant kind of revenue and earnings growth because it will, at a minimum, start to match what sell-through is.

So I can't tell you the exact timing. I wish we had a crystal ball to be able to do it. I think we're largely working through some of the inventory issues. If you go to some of the larger companies, the largest shoe wear company, footwear company in the world said they thought by the end of their kind of second quarter, which ends in May, they would largely be rightsized with inventory. I don't know that that's representative of every footwear company, but I bet you that is representative of where the industry is going.

So if I had to take a guess, I think as we get through Q2, we probably start in Q3 getting some kind of orders to revert back to normal, and then I think Q4 is going to look very strong for both of those businesses. But frankly, that's more of trying to put together a mosaic from what you're hearing in the marketplace and it's not based on analytical data that we've got coming in right now.

But I do think we can all anticipate the snapback is going to be very strong. And I think because this started in the fourth quarter really with PrimaLoft, we started seeing this in the third quarter of '22; in BOA, we saw it in the fourth quarter of '22, we're about ready at the back of this year to start entering some much easier comparisons. And I think as a result of that, it's going to take some of that pressure on earnings off. And even if the snapback isn't until the fourth quarter or even the first quarter, we're just not going to have these severe headwinds because the comparison gets so much easier.

So we feel very good that as we get to the second half of the year, the portfolio will show and deliver growth, and that's why we're very confident that we'll get growth for the whole year. But I can't predict with any exact certainty when the snapback will be at BOA and PrimaLoft, but I think it's going to be really strong, and we're all going to feel really good when it happens.

Cristopher David Kennedy

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William Blair & Company L.L.C., Research Division

No, I appreciate that. And then just a clarification on PrimaLoft not meeting your initial expectations, is that primarily related to the inventory issue? Or is there something more going on there?

Patrick A. Maciariello
Partner & COO

Yes. This is Pat. Their customer acquisitions have been at or above our expectations. Their sort of new technology rollouts has been at or above our expectations. It's just, again, the existing customers and existing SKUs, the orders and the replan orders have been less than we expected due to what we perceive and what we're confident in our inventory issues in the supply chain.

Operator

Your next question comes from Matt Koranda from ROTH MKM.

Michael David Zabran
ROTH MKM Partners, LLC, Research Division

It's Mike Zabran on for Matt. Just starting with Velocity. Both top line growth and margins were under quite a bit of pressure in Q1 from the lower sell-in. But when are we expecting retailers to start stocking up for the summer quarters? What does that mean for overall seasonality throughout the year? In turn, should we expect the typical 3Q seasonality in Velocity to be less aggressive this year, given we're still seeing some caution from key retailers?

Patrick A. Maciariello
Partner & COO

Yes, there's a lot there. So let me unpack it a little. I'd say we think Q2 will be better than Q1, and Q3 will be better than Q2. So let me start with that sequentially, right? Within that, we do believe we will see more sort of strength in the archery side than in the airgun side, given those dynamics you talked about around hunting and gearing up for hunting, if that makes sense. So Q1 was very weak. I would see Q1 as being a smaller percentage of the year than normal. Absent that, we don't really have too much clarity.

Michael David Zabran
ROTH MKM Partners, LLC, Research Division

Got it. That's helpful. Moving to working capital, specifically on inventory. How are we thinking about inventory, about how the inventory balance should move throughout the year, given the different puts and takes from store and salon build-out to 5.11 as well as further the caution we're seeing from key retailers around restocking?

Ryan J. Faulkingham
Executive VP, CFO & Co-Compliance Officer

Yes. So I think what you guys saw is at least in the cash flow statement or use of inventory in the first quarter, and that was at really 2 businesses. That was 5.11 and Lugano, and both of that really was to support the growth we saw exiting 2022, but also the first quarter. So as we progress through the year, both inventory and working capital, we expect to come down for a majority of the businesses, the exception being Lugano, right? If we continue to see this type of growth, we will continue to support that business with inventory. Outside of them, though, we should see a significant cash conversion amongst the other 9 subsidiaries as the year progresses.

Michael David Zabran
ROTH MKM Partners, LLC, Research Division

Got it. That's helpful. Last one for me, guys. Just on the health care front, maybe just an update on where we stand in building out a team there. Has the appetite for a potential acquisition within 2023 changed at all? And maybe just speak to the relative size of the pipeline and how we feel about current private market valuation, specifically in health care.

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Elias Joseph Sabo
Partner, CEO & Director

Yes. So really no major update from where we were in the last conference call. Team remains the same led by Curt Roth and then kind of assisted by human capital that we have within the firm kind of at various levels, and that's how staffing will look until we start to kind of get a couple -- a company or 2 acquired and then we'll start building up that kind of vertical segment from a human capital standpoint.

In terms of desire to do a deal, it's there. We want to be able to kind of get some health care assets invested in and kind of in-house. Unfortunately, Mike, the M&A markets remain really suppressed, and it remains suppressed around kind of all categories. Sellers continue to be very cautious. I don't think what's happening in the kind of bank market helps. So when you see regional banks going out of business and their cost of capital, kind of investment-grade rated capital going into junk territory right now, that's not kind of conducive to the M&A markets just broadly. So we continue to see that, I think, being a kind of a huge weight on all markets.

Now all that being said, there are a couple of health care deals that have come through that have priced. I'd say broadly, the pricing has been more elevated than one would anticipate, given the massive run-up in capital costs over the course of the last year. And I would say pricing has really been more consistent with kind of where pricing was in the free money economy of '21 and prior to that than it should be in an economy that has a 5% federal funds rate right now, and I think it's indicative of the fact that there's just a lot of capital out there that is sitting on the sideline.

And when you think about kind of the private markets, where we are generally competing for these assets against private equity buyers, there was just an enormous amount of capital that has been raised and continued to be raised up until kind of the last year, 1.5 years. Those funds all have relatively short-term time horizons. It's one of the things that we always point to as being a key differentiator in CODI's business model. Our competitors have to put money to work over a 5-year period. We were able to be more patient and pick and choose when we want to put money to work and not really suffer from that moral hazard of you either put it to work or you lose it, and that creates incredible divergence of interest between investors in those private equity efforts and the management teams and general partners. And luckily, our business model really eliminates that and avoids that moral hazard.

Now if you think there's 5-year commitment windows in traditional private equity, we're now 1.5 years into this Fed tightening cycle and the M&A markets being flat on their back. That basically ate up 1/3 of the kind of time under which P/E funds can put their money to work. It's creating -- in our opinion, that overhang will create really a level of desperation, and we're sort of seeing that when the limited number of assets come to market.

So private market pricing remains elevated. We really can't find price discovery outside of health care because really not much is going on. But in the health care space, there have been a couple of deals. And I would say, if you're a seller of a health care company, now is not a bad time to go to market because that overhang is driving prices. And even though you can't get financing, I think some of the players in the market today are just assuming that financing, they can take out financing a year or 2 from now when markets become more accommodative, and these assets are being bid up at kind of prices that, in some cases, make you scratch your head.

So it's not -- I think it will -- this is something we've dealt with, by the way, high pricing for the better part of the last decade. So it's not something that's unique right now. But I would say pricing continues to remain elevated for the limited number of deals that we see in market.

Operator

Your next question comes from Kyle Joseph from Jefferies.

Kyle Joseph
Jefferies LLC, Research Division

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Just kind of a follow-up there. Obviously, you were focused on health care there. But CODI, at least in COVID, has kind of had a history of zigging when others zag. And you guys did 2 acquisitions during the pandemic, which have obviously been very fruitful, but it sounds like prices have been stubbornly high. But so just thinking about rate, leverage and market dislocation in terms of your capital allocation strategy, is now the environment where it's kind of a layer-on acquisition environment? It doesn't sound like there's a lot of platform acquisitions out there given the M&A., but just kind of thinking about how you guys are thinking about capital allocation in this, given all the dislocation in the market.

Elias Joseph Sabo
Partner, CEO & Director

Yes. So Kyle, I think, one, you're right. We are looking more on add-on acquisitions, and those generally tend to be much smaller. The competitiveness is typically a lot less, and pricing comes in at much better price, at much better levels. And then obviously, you have kind of either cost savings or revenue synergy opportunities that we look to extract. And kind of you can look at the most recent acquisition we made of Baum Bat into Marucci Sports. We think that's going to be a great opportunity to add that brand and a different technology, and there's some real revenue synergies that exist. So we couldn't be more thrilled to acquire a company like that. But I would anticipate we're going to see more bound-type kind of acquisitions, not from just Marucci, but in terms of add-on acquisitions that have either good cost saving or synergy opportunities within our portfolio.

I think you're also right that given the dearth of new platform opportunities that are out there trading and when there is kind of 1 or 2, they seem to fetch pricing that doesn't take into account the new elevated kind of borrowing cost that we have. I think it's probably a bit more of a stretch to think that we'll do a platform, although sometimes these things can come up and we can find one. And we think there is great value, and we can move really quickly. So I don't want to rule it out, but I would just say from a probability-weighted basis, it's a bit less likely that we're going to find that.

So when you think about capital allocation, I would say #1 priority within our firm is to fund the kind of high-return opportunities within our portfolio, and Lugano clearly kind of goes to the top of that list. You see that as we've been building inventory in the company, we've been generating and generated plus 30% growth rates in that company. I think there's a lot of runway to continue to invest there and have very high return on invested capital. 5.11 has been another company where by building out its store network, we've been able to get a very high return on invested capital. So that will clearly be priority #1.

Priority #2 will be to acquire companies, principally add-ons because I think platforms will be a little bit harder to come by. And then our third capital allocation priority, as you know, right now, is the buyback. And although our goal is to grow, and we need capital to grow, so doing a buyback on top of returning capital through a dividend doesn't really feel like kind of consistent with our long-term growth plans. We are in a short-term period where these price levels are just extraordinarily disconnected from the reality of what our businesses are worth. And so it makes more sense for us just to continue to buy back our stock and accrete value to our shareholders.

And I said this on the last conference call, and I'll reiterate it today. If someone is so short term-oriented to want to sell our stock because BOA and PrimaLoft are going through inventory destocking, then we'll happily buy it back for our shareholders who are more long-term oriented and will accrete value because there will be a big snapback in both of those businesses, and our growth rate will revert back to its historical averages.

And so for us, it's going to be a sacrifice, where we're going to sacrifice using capital to potentially even stock on our balance sheet for a future acquisition or do acquisitions now because the best opportunity to accrete value for our shareholders is through execution of this buyback. And so at some point, I think maybe the stock will react and come back, and that will become less of an opportunity. But in the current environment with this current reality, that has to be a high capital allocation priority.

Operator

Your next question comes from Sean-Paul Adams from Raymond James.

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Sean-Paul Aaron Adams
Raymond James & Associates, Inc., Research Division

It seems like you pretty much hit everything I had with BOA and PrimaLoft. Basically, if I understand you guys correctly, that you don't really know if this is going to continue past 2Q. So adjusting run rate on that might be a little bit difficult. But as far as PrimaLoft goes, have you guys seen any interest in any other regions?

Patrick A. Maciariello
Partner & COO

Any other regions? Yes. I mean we sell globally, right? So our brand partners manufacture through contract manufacturers in Asia, and then they sell globally, and you'll see the PrimaLoft brand on a lot of brand -- snow gear, outerwear everywhere, right? So I think when you say other regions, we do have some projects we're specifically working on in Europe now that could be accretive. But other than that, I'm not sure. We sell globally. We ship primarily to -- or we have -- we work with our manufacturing partners in Asia who then sell to the partners of our end customers, mostly in Asia, and then those are shipped globally. Does that make sense?

Sean-Paul Aaron Adams
Raymond James & Associates, Inc., Research Division

Yes. Yes, to clarify, I meant that approximately 83% of the revenue was coming from Asia Pacific so -- which is, of course, because of the textile industry. But I didn't know if you guys were getting any interest from -- sell directly to any...

Patrick A. Maciariello
Partner & COO

We can't track exactly where it ends up. Does that make sense? So that's where the buyers are contracted from the brands, and there's kind of a pass-through there. So that's -- actually, you're right. That is where the revenue comes from, but that's not where the consumer buys the product, if that makes sense.

Operator

There are no further questions at this time. I would now like to turn the conference back to over Mr. Elias. Please go ahead.

Elias Joseph Sabo
Partner, CEO & Director

Thank you, operator. As always, I'd like to thank everyone again for joining us on today's call and for your continued interest in CODI. Thank you for your support.

Operator
This concludes Compass Diversified's conference call. Thank you all, and have an excellent day.

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