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Compass Diversified NYSE:CODI

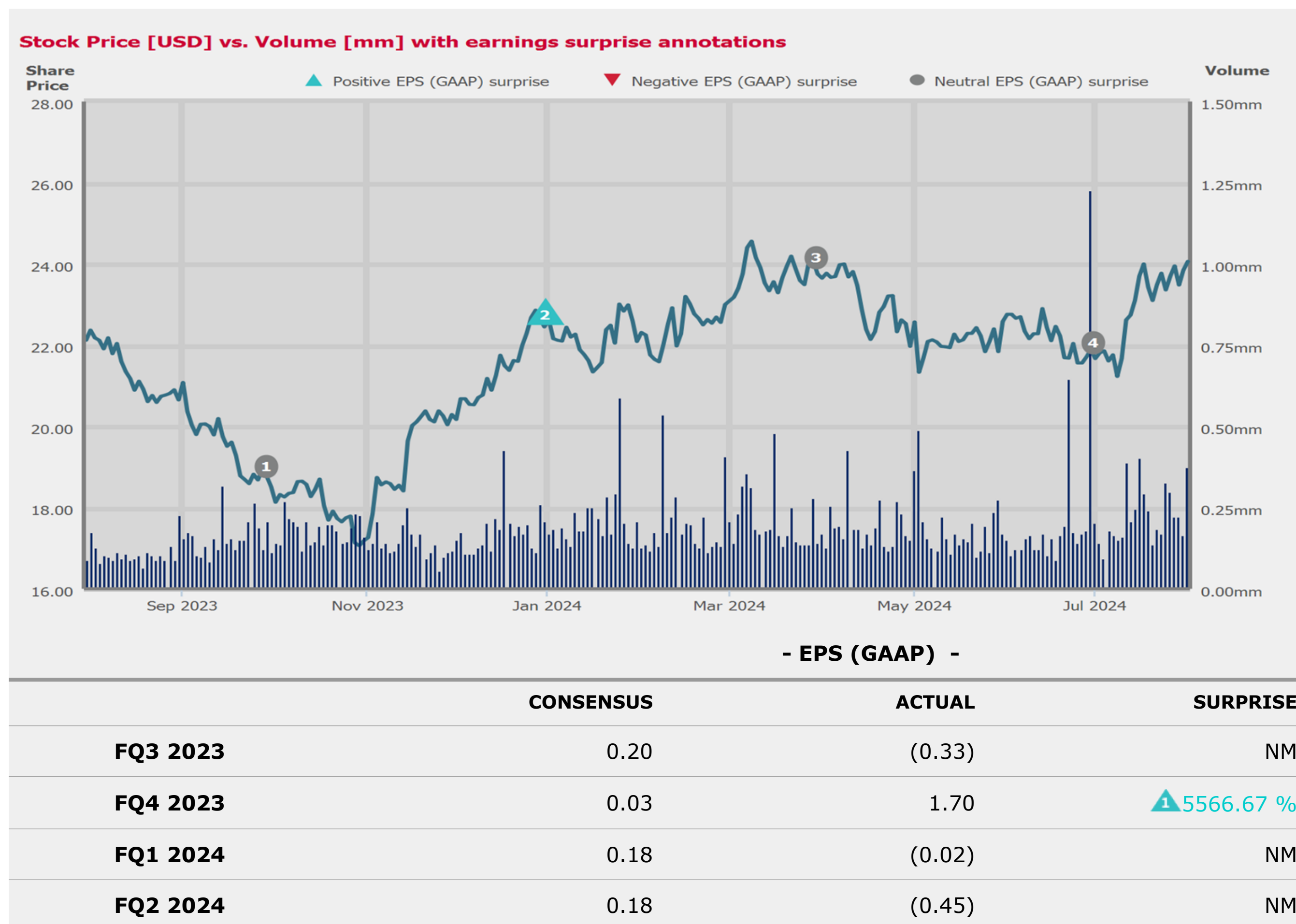
FQ2 2024 Earnings Call Transcripts

Wednesday, July 31, 2024 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2024-			-FQ3 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS (GAAP)	0.18	(0.45)	NM	0.18	0.63	1.01
Revenue (mm)	550.13	542.60	(1.37 %)	577.42	2277.36	2457.30

Currency: USD
Consensus as of Jul-22-2024 5:26 AM GMT



- EPS (GAAP) -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2023	0.20	(0.33)	NM
FQ4 2023	0.03	1.70	5566.67 %
FQ1 2024	0.18	(0.02)	NM
FQ2 2024	0.18	(0.45)	NM

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Cody Slach
Gateway Group, Inc.

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Presentation

Operator

Good afternoon, and welcome to Compass Diversified's second quarter 2024 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 second quarter 2024 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'd like to point out that the Q2 2024 press release, including the financial tables and non-GAAP financial measure reconciliations for subsidiary adjusted EBITDA, 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 in 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 2024 adjusted earnings, adjusted EBITDA or subsidiary 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 conference call, we may make certain forward-looking statements, including statements with regard to the expectations related to the future performance of CODI and its subsidiaries, the impact and expected timing of acquisitions and divestitures and future operational plans such as ESG initiatives. Words such as believes, expects, anticipates, plans, projects, should 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, 2023, as well as in other SEC filings. In particular, the domestic and global economic environment, supply chain, labor disruptions, inflation and changing 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 because 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

Good afternoon, everyone, and thanks for joining us today. I am pleased to report yet another strong quarter of results. Continuing to execute our strategy of owning a growing number of innovative, disruptive and high-growth businesses meant we performed exceptionally well in the second quarter, even against the backdrop of a slowing economy.

While the current business environment has had a negative impact on our industrial businesses, our branded consumer vertical performed extremely well this quarter. Led by BOA, PrimaLoft and Lugano,

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the strong performance of our consumer vertical more than offset any weakness we saw in our industrial businesses.

As we predicted in Q1, inventory destocking headwinds subsided this past quarter. And because of this, BOA had another great quarter and PrimaLoft returned to double-digit growth. We believe both businesses are positioned for a strong back half of the year.

In addition, Lugano continued its trend of remarkable growth. Last quarter, we opened our first international salon in London. And in just a few short months, like many of our Lugano salons, it has vastly exceeded our expectations.

Combined, Lugano, BOA and PrimaLoft represent approximately half of our EBITDA. With all 3 of these businesses performing so well this past quarter and with them positioned so strongly for the rest of the year, we are feeling bullish about the second half of 2024 and beyond. As I mentioned earlier, despite our overall outperformance this quarter, a weakening global macro economy made for a challenging quarter for our industrial businesses.

Our industrial vertical saw a decline in both revenues and adjusted EBITDA in Q2. We believe this somewhat muted performance will continue through the rest of the year. However, we remain confident in the overall positioning of this vertical, and we believe it is well positioned for a strong 2025.

All in all, it was another great quarter for CODI, and one that further demonstrated the power of our long-term strategy. By owning a group of noncorrelated, high growth innovative businesses, we not only smooth CODI's overall performance period to period, but in any given period, are more likely to benefit from one or more of our businesses experiencing a true step change in growth. This is a story of diversified growth engines as evidenced this quarter when we grew by almost 20% year-over-year.

Ryan will go into detail on our financial outlook shortly, but I'd like to briefly discuss our decision to leave our outlook unchanged. We still anticipate we will hit the high end of our consolidated guidance ranges. However, we are not raising our guidance range at this point out of an abundance of caution regarding the weakening economy and a concern for the short-term performance of our 3 industrial businesses. But overall, we remain really positive about the rest of the year.

As Ryan will detail shortly, within our overall outlook, we are shifting some of our adjusted EBITDA expectations from our industrial vertical to our consumer vertical. Even though our overall guidance is staying holistically the same, we believe this mix shift that favors our faster growing, more protected and highest value businesses creates an accelerated level of intrinsic value creation for our stakeholders now and positions us to drive significant growth into 2025 and beyond.

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

Patrick A. Maciariello
Partner & COO

Thanks, Elias. As a reminder, throughout this presentation, when we discuss pro forma results, it will be as if we owned the Honey Pot Co. as of January 1, 2023.

I am pleased to report on another successful quarter. On a combined basis, pro forma revenue and adjusted EBITDA grew by 6% and 18%, respectively. On a year-to-date basis, pro forma revenue and adjusted EBITDA increased by 4.9% and 16.6%, respectively, versus year-to-date June 2023.

Tho Lugano continues to be the largest driver of growth we saw a broadening of strength with very good performance at both BOA and PrimaLoft this quarter. As Elias touched on, we believe all 3 of these businesses are well positioned for growth in the remainder of the year and beyond.

Within our Industrial segment, for the year-to-date period, revenues decreased by 6.7% and adjusted EBITDA decreased by 8% versus year-to-date June 2023. This decline was primarily driven by weak performance at Altor, which declined meaningfully in Q2. The decline was driven by a combination of reduced customer demand in some accounts and churn at a couple of our cold chain distribution partners. Though disappointing, the sales funnel at Altor remains robust and has almost tripled in size since this

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time last year. New contracts typically take some time to design and test, however, leading to a potentially muted second half of 2024.

As a reminder, the company now has what we believe to be a world-class management team in place. And as a result, we are confident the company will rebound in 2025. Arnold continued to grow revenue in the quarter though once again, experienced higher SG&A as we began to modify our manufacturing footprint in an effort to improve efficiencies and grow technological capabilities. As part of this strategic relocation, we anticipate several million dollars in onetime expenses will be incurred over the next few quarters. In addition, we expect $10 million to $15 million in onetime capital expenditures as part of this project as we make our way through this transition.

Sterno once again grew EBITDA modestly in the quarter as slightly softer sales in the company's food service division were more than offset by strong execution throughout the business.

Turning to our Consumer Segment. For the year-to-date June 2024 period, pro forma revenues increased by 10.9%, and pro forma adjusted EBITDA increased by almost 27% versus year-to-date June 2023. Lugano remained the strongest performer, both in the quarter and on a year-to-date basis. Our London salon significantly exceeded expectations during its first quarter of operation, and we continue to see strong performance in Aspen, Palm Beach and Newport Beach. We're in the process of finalizing the location of our ninth salon and look forward to sharing its location with you likely on our next quarterly call. We expect Lugano's extraordinary growth to continue throughout the rest of this year and into 2025.

I'm also very pleased to report on the acceleration of BOA in the quarter and PrimaLoft's returned to growth in the period. For the second quarter, BOA grew revenue by 42.1% and adjusted EBITDA grew by almost 60% versus Q2 2023. Tho BOA brands saw growth in each of its industry verticals. Similarly, PrimaLoft grew revenue and EBITDA by 14.1% and 11.1%, respectively, as inventory headwinds in many of its apparel categories continued to abate as expected. We are encouraged by the performance of both PrimaLoft and BOA this quarter and by their prospects for the rest of the year.

Turning to the Honey Pot Co. Both for the quarter and for the year-to-date period, Honey Pot declined slightly in both revenue and EBITDA versus the same period in 2023. We purchased the company with a knowledge that Honey Pot was losing a small number of noncore SKUs at one of its large national retailers. The short-term impact was slightly greater than our expectations. And as a result, Honey Pot's financial performance has been slightly below our expectations for the year-to-date period. The company continues to add new retail and online accounts, however, and we remain confident in the long-term mission-driven trajectory of the business.

Lastly, on 5.11. 2024 represents somewhat of a transition year for the business given the previously announced leadership changes, lingering inventory-related issues in DTC, and the challenging PFAS transition. As a result, financial performance was somewhat muted in both the quarter and year-to-date period. However, demand for the brand this year, particularly in the professional side, remains robust.

While we see financial performance in the remainder of 2024 looking similar to performance in the year ago period, we continue to expect strong growth in 2025 and beyond, following resolution of these exogenous issues facing the business. As a whole, we are very pleased with the first half and remain confident in our outlook for the full year.

I will now turn the call over to Ryan for additional 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 June 30, 2024, 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.

On a consolidated basis, revenue for the quarter ended June 30, 2024, was $542.6 million, up 11% compared to $486.9 million for the prior year period. This increase was primarily a result of the acquisition

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of the Honey Pot Co. and strong growth at Lugano, BOA and PrimaLoft, which was partially offset by lower revenue at Altor, 5.11 and at Velocity as a result of the sale of its Crosman division.

Consolidated net loss for the second quarter of 2024 was $13.7 million compared to net income of $17.1 million in the prior year. The second quarter of 2024 included a loss on the sale of Crosman of $24.6 million as well as a $7.3 million tax expense recorded at Velocity related to a valuation allowance on its deferred tax assets.

Adjusted EBITDA in the second quarter was $105.4 million, up 27% compared to $82.9 million in the prior year. The increase was due to the acquisition of the Honey Pot Co. and strong growth at Lugano, BOA and PrimaLoft. Included in adjusted EBITDA in the second quarters of 2024 and 2023 were management fees and corporate costs of $21 million and $19.3 million, respectively. Adjusted earnings for the second quarter were above our expectations, coming in at $39.8 million. This was up significantly from $29.2 million in the prior year quarter due to strong performances at Lugano and BOA.

Now moving to our 2024 guidance. As a result of our financial performance in the second quarter, our expectations for the remainder of 2024 and our current view of the economy, we are maintaining our 2024 outlook. Thus, our full year 2024 subsidiary adjusted EBITDA is consistent with what we provided on our last earnings call of between $480 million to $520 million.

Given the outperformance of our branded consumer companies, we are increasing the subsidiary adjusted EBITDA range for our branded consumer vertical by $10 million to $365 million to $395 million. However, we are reducing the subsidiary adjusted EBITDA range for our industrial vertical also by $10 million to $115 million to $125 million.

We expect full year 2024 adjusted EBITDA to be between $390 million and $430 million, consistent with what we provided on our last earnings call. This range factors in an expected $86 million in corporate-level overhead and management fees in 2024. This compares to $341 million in adjusted EBITDA in 2023.

Finally, we are maintaining our full year 2024 adjusted earnings guidance range of between $148 million and $163 million, and we expect the remaining 6 months of adjusted earnings to be slightly more skewed toward the fourth quarter.

Turning to our balance sheet. As of June 30, 2024, we had approximately $68.4 million in cash, approximately $544 million available on our revolver, and our total leverage ratio was 3.72x. Our leverage ratio at the end of the quarter declined, as anticipated, as a result of our strong operating performance. Absent any significant acquisitions for the remainder of 2024, we expect our total leverage ratio to continue to decline.

We have substantial liquidity. And as previously communicated, we have the ability to upsize our revolver capacity by an additional $250 million. 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.

Turning now to cash flow provided by operations. During the second quarter of 2024, we used $35 million of consolidated cash flow from operations. Lugano used $71 million in cash flow from operations to support its continued extraordinary growth. Outside of Lugano, the other 9 subsidiaries combined produced $36 million in cash flow from operations in the second quarter, allowing us to reduce our leverage as stated earlier.

And finally, turning to capital expenditures. During the second quarter of 2024, we incurred $11.2 million of CapEx at our existing subsidiaries compared to $13.7 million in the prior year period. The decrease was primarily a result of a decline in 5.11 store rollouts in 2024.

For the full year of 2024, we anticipate total capital expenditures of between $55 million and $65 million. We continue to see strong returns on invested capital at several of our growth subsidiaries and believe they will have short payback periods. Capital expenditures for the remainder of 2024 will primarily be at Lugano for new retail salons and at Arnold, as previously discussed by Pat.

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

Elias Joseph Sabo
Partner & CEO

Thank you, Ryan. Before moving to the Q&A portion of the call, I'd like to briefly discuss both our ESG strategy and the current M&A market.

As we have told you before, our business model is designed to foster the long-term development and growth of our subsidiaries. We are not constrained by short investment horizons and our permanent capital base allows us to take a long-term view. This approach is vital because meaningful innovation and industry disruption both require time, and they also require an exceptional talent pool.

The Future Thinking for People and Planet pillar of our ESG strategy prioritizes attracting the best people and focusing on their professional development and holistic well-being. Additionally, our commitment to diversity and inclusion enriches our teams with a variety of perspectives and experiences. We have integrated these principles into our business model so that we can attract and keep people who are not only really good at what they do, but who will also join us in taking bold steps, pushing boundaries and creating lasting value for our stakeholders.

Turning to the M&A market. While there has been an uptick in deals recently compared to what we've seen in years past, we have not returned to historic activity levels and recent deal quality hasn't met our standards. We remain steadfast in our efforts to identify, own and actively manage innovative, high-growth companies. We also believe our competitive edge will shine in today's high interest rate landscape. When debt markets are weak for single asset buyouts, our permanent capital competitive advantage only grows.

As Ryan mentioned, our strong liquidity position also enables us to act on acquisition opportunities and to invest in our subsidiaries to build upon our track record of delivering growth into 2025 and beyond.
With that, operator, please open the lines for Q&A.

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Question and Answer

Operator

[Operator Instructions]. Our first question today comes from Larry Solow of CJS Securities.

Lawrence Scott Solow
CJS Securities, Inc.

Great. I guess 2 questions, one operating and one just on the M&A environment. Just it sounds like BOA had a really nice quarter, really good to see. Can you maybe give us a little more color on the strength? Is it just the subsiding of the inventory destocking? And is BOA the primary driver of the $10 million increase on the branded side?

Patrick A. Maciariello
Partner & COO

I would say it's certainly one of them, Larry. This is Pat. It was really broad breadth, as I mentioned, across each of the BOA verticals. I would say the company is developing a great business in workwear, and it's becoming a more material part of their business, and that was certainly a driver of growth here as well, both domestically and internationally.

Elias Joseph Sabo
Partner & CEO

Yes. With respect to the $10 million driver of growth, Larry, I would say, is sort of a combination. PrimaLoft bounced back and exceeded our expectations as did BOA, the numbers BOA put up are really extraordinarily -- extraordinary. And as you know, this has been one of the better performing businesses that we've owned prior to the inventory destocking. So it's really good to see that behind them and get back on kind of a normal growth trajectory.

And then, of course, Lugano continues just to grow at a remarkable level. And so those 3 together, and as I said, they roughly represent half of our EBITDA. Having them be growing like they are right now, that kind of enables us to up our expectations in the back half of the year -- or for the full year by $10 million on the consumer side.

Lawrence Scott Solow
CJS Securities, Inc.

And just on the Honey Pot, a little bit below expectation, as you called out. Some of it, you -- it sounds like your thoughts on, really, you were going to lose some of these SKUs. Is it also some traffic at these bigger box retail stores one in particular? And is that still -- the big box still the majority of your revenue?

Patrick A. Maciariello
Partner & COO

Yes. Those -- a couple of the bigger box stores are close to half of our revenue or slightly more than that, probably are a good chunk of our revenue. And I would say there is some well-publicized traffic reductions at, at least one of those that would come into account.

Lawrence Scott Solow
CJS Securities, Inc.

Fair enough. Okay. Just last on the acquisition environment. Just curious. Obviously, multiples haven't really come down. And I know in the health care, in particular, I'm just curious your thoughts. No time table, and I'm sure you've -- Kurt's a good man, so I'm sure you've repurposed him and doing a lot of good stuff behind the scenes there. But curious, are you expanding your horizons a little bit around health care? Again, just any thoughts on potential investments in that vertical specifically.

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Elias Joseph Sabo
Partner & CEO

Yes, Larry, I would say just in general, in the M&A market, there is increased deal volume, as I mentioned, but we're really kind of focused on making sure that companies are very innovative in what they do today and their products and the margins they can enjoy from that, but then have a source of continuing innovation to be able to continue to enjoy that. And I would say that really narrows down the target opportunities pretty significantly out of what we will go after. Unfortunately, broadly, the market -- in the market, we haven't seen those really premium companies coming to market yet. But I think that's probably -- there's some green shoots in that the market is recovering.

In terms of health care, in particular, and by the way, this goes across great consumer and great industrial. When you see an A or an A+ business, which are the kind of businesses that we look for, these things are -- they always trade at premium multiples because they don't trade in compromised times typically. And so our expectation is when these businesses come, we're going to have to pay a clearing multiple. It kind of gets circular back to the fact that we're just not seeing a lot of them out there.

With respect to health care, we are opening the parameters a little bit. I would say kind of we would consider something maybe a little bit smaller than kind of the historical deal sizes that we've done, maybe down in the $15 million EBITDA range, so dipping a little bit lower with a more of a build strategy. But other than that, we're remaining very disciplined in what our criteria are.

Operator

And the next question that we have is coming from Matt Koranda of ROTH Capital.

Matthew Butler Koranda
ROTH MKM Partners, LLC, Research Division

Maybe just sticking on the deal front for a second. I'm just curious, it sounds like a little bit of a tone shift from you guys in terms of just a little bit more awareness on a slowing or softening economy, especially on the industrial side of things. Does that change your posture toward -- or appetite for larger acquisitions going forward here?

And maybe, Elias, if you just unpack your commentary around deals not meeting your standards. It sounds like it may be more quality of deal flow. But maybe just curious if you could talk a little bit about pricing expectations and sort of if you could unpack that theme as well, that would be helpful.

Elias Joseph Sabo
Partner & CEO

Yes. Sure. I mean, Matt, we've -- it feels like the economy is weakening, and we clearly factored that into our expectations in the back half and that's why we didn't raise, notwithstanding having a really good quarter and feeling really good about the business. But that obviously factors into how we're looking at companies right now, too, in that there's probably going to be some reduced expectation of growth at a minimum or maybe even they don't grow at all as the economy feels like it's reining in a little bit.

So that impacts our view of forward earnings, which is going to impact our view on kind of valuation. And that may or may not allow for us to be competitive because we have maybe a slightly more negative view of kind of how the economy is unfolding right now.

I would say in terms of multiples, we expect to pay more elevated multiples. And if you think of the businesses that we've acquired recently, PrimaLoft and BOA as 2 examples, those are companies that traded kind of in mid-double-digit range, kind of 15-ish times. And these are incredibly high-quality businesses with really deep economic moats. And those are the kind of businesses that we're looking for. I mean we want a source of real innovation. We want protected IP or some go-to-market strategy that we can feel really good about as being durable. And ultimately, it needs to manifest in the company being able to significantly outgrow -- outgrowing its underlying industry.

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And so those are sort of the criteria that we're evaluating. And this has been part of our sort of strategic, sort of -- kind of not shift, but as our capital costs have come down, we've been talking to you about buying faster-growing businesses and more well protected, those 2 things have gone hand in hand. And so that is what we are looking for, and we're very strict about meeting that criteria.

And I would just say whether you're today or a year ago or you're back in '21 when times were really robust, or '19, those companies always trade for strong multiples because when you identify companies with those characteristics, it's typically about, you have to pay the clearing price for those, and those are really in-demand assets.

When we look back historically at our performance, notwithstanding they're our highest priced assets, they're also our best-performing assets on return on invested capital as well. So that's sort of where we see the deal market right now, and volume has come back. But as you said, quality is still lagging.

Matthew Butler Koranda
ROTH MKM Partners, LLC, Research Division

Okay. Very helpful. And then just curious, maybe on the balance sheet front. Like if we're a little bit more reticent about the economy, why not focus on reducing that leverage? I know that you already are starting to do so. And you mentioned that without a deal, I guess, we just naturally sort of delever over the next couple of quarters.

But maybe if you could talk about the trajectory there, where we might expect to end the year on that leverage if we didn't see a deal and maybe would that be a priority of ours, like if we kind of see things softening a bit?

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

Yes, Matt, this is Ryan. Thanks for the question. You're right in that our leverage is continuing to come down, and you heard us on the past few calls talk about that. Post the Honey Pot transaction, we're seeing some continued really strong performance at our consumer subsidiaries, which is growing the denominator there. So as we build our business, our leverage is coming down, came down from a little above 3.8%, down to about 3.7% this quarter. I'd expect kind of similar declines over the next 2 quarters as we not only grow the EBITDA line, but we start to cash convert some of our other subsidiaries' inventory and such.

So still a focus of ours. I'd say it's more organic. I think what you also saw during the quarter is we raised a little bit of preferred. So I think that's been a good source of some equity capital for us to deleverage. But I do think we feel confident in our growth prospects for this year. Clearly, we're guiding to north of 12% growth in EBITDA year-over-year. So I think that all feels good. So I think we're in good shape on the balance sheet as I think about closing out the year.

Matthew Butler Koranda
ROTH MKM Partners, LLC, Research Division

Okay. Great. And if I could just do one more on one of the fundamental businesses. So on Lugano, I wanted to hear if you guys had any sort of preliminary learnings you can share from the London salon opening. Like if you have quantifiable metrics, that's great, but just any learnings around that and how that sort of informs the additional expansion plans you may have for the rest of Europe.

And also, I guess I noticed that the incrementals there just continue to be really strong, and it's kind of hard to model this thing, given you're punching above 40% in terms of incrementals. How sustainable is that? Sort of how should we think about modeling that going forward? I would assume you're probably going to try to temp us down on that front, but it was impressive. So I just wanted to hear a little bit more on that.

Patrick A. Maciariello
Partner & COO

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Sure. I mean the company does a great job -- you said some of the learnings that we take from London, the company does a great job of sort of seeding the market with a lot of deep relationships before they enter a market. And they did the same thing here in London. We had a smaller business working with European equestrian customers that we spent some time with and that helped us seed this market when we went into London. So that would be point one.

Point #2 would be that our sort of -- the way we do business, which is sort of deep relationships and good value on really amazing product works over there as well. And so there was some sort of you work a buyer who buys differently, you work with customers who purchase differently. We're learning that it works there as well, and we're optimistic that there are several more at least European locations that it could work to. So it only made us more bullish on sort of growth internationally and growth within Europe.

As far as the growth. I'm not going to make your modeling exercise any easier. I'm sorry, Matt. I think we're going to continue to see really robust growth in 2024 and into 2025. And the robustness of that beyond that will somewhat be determined by the number of salons we open and somewhat just be driven by continued growth at the company and continued depth of relationships.

Matthew Butler Koranda
ROTH MKM Partners, LLC, Research Division

Got it. Any rule of thumb around inventory investment translating to sort of sales? I think you guys have provided some metrics around that. Just I'd be curious if you have another crack at that one or if anything has changed on that front.

Elias Joseph Sabo
Partner & CEO

Yes, Matt, it's basically remained similar to where it's been. I would say we do have some additional investment we're making upfront. As our growth rate is actually accelerating, which is really remarkable given how fast this business has been growing. But as it's accelerating, it actually requires a little bit more upfront capital, especially as we're expanding our footprint. And for example, going to London, now being international, it creates some challenges about moving inventory that kind of required a little bit more investment.

So in general, I would say the numbers are sticking exactly where they have been historically. And as we look at the business, I mean, part of the question that Pat said on your -- or answer Pat did for your question on modeling, I mean, the level of inventory investment also is a kind of component to modeling out how large and fast this business will grow. We've said this for 3 years, and I know it's hard for everybody and for us, too, to accept a little bit that as we put in more inventory, there is kind of demand within our network. And as we're growing that network of buyers for, there's additional demand that is there. And so we are creating more revenue opportunity with inventory investment.

I think that continues and that has not slowed down. And so as we look into 2025, other than a desire to be a little bit more conservative and not get out over our skis, I would say there's nothing present right now that says this business should have a material change in sort of kind of its performance and growth outlook, it's going to be the kind of same thing. It's getting the people onboarded, getting kind of the product and the inventory built, those are sort of some of the constraints right now that we have to grow. It feels like demand still is solidly more within our network than what we're currently satisfying.

Operator

Our next question will be coming from the line of Derek Sommers of Jefferies.

Derek Sommers
Jefferies LLC, Research Division

A couple of quick questions on the subsidiaries. Just on Honey Pot and Lugano, could you remind us if there's any sort of seasonality we should be cognizant of in modeling those? And then additionally, any kind of commentary on the 5.11 business transition or transformation will be helpful as well.

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Elias Joseph Sabo
Partner & CEO

Sorry, what was the second part? 5.11.

Patrick A. Maciariello
Partner & COO

So seasonality at Honey Pot, I mean, it's lessening. I think Q1 tends to be a pretty strong quarter for them. But other than that, there doesn't -- there's not too much seasonality. At Lugano, I think we've tended to see sort of Q4 and Q1 be bigger than Q2 and Q3, and it just depends on the year.

As it relates to the 5.11 transition, we're spending a lot of time working on sort of opening up the aperture for 5.11. And how do we bring in more customers to this product that just performs incredibly well and has an incredibly trusted and authentic brand. And so we're spending a lot of time understanding just how we do that. And that's been a big part of our focus over the last sort of 2 to 3 months and will be for the next 3 to 4 months.

What also is happening though, at the same time is inventory fluctuation still related to COVID where you purchase too much or too little is impacting our retail sales somewhat in DTC. And then lastly, as I touched on with PFAS we have a lot of different SKUs that we now need to bring in PFAS-free product for, and it's a relatively complex process. Different states -- different agencies in different states and different consumer wholesale customers will demand different specs. Some will want PFAS products, some will not.

So you essentially have to keep double inventory on a lot of products. And that's presenting us with some operational challenges. I think we're going faster than most in the industry. And so I think it could potentially be a tailwind when we get through it in 2025, but it is a bit of a headwind right now.

Derek Sommers
Jefferies LLC, Research Division

Got it. And then just on the interest rate cuts, it will flow through on your variable rate debt at the corporate level. But is there any kind of interest rate exposure we should be aware of at the subsidiary level?

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

No, Derek. All that subsidiary debt is owed us. So there's no exogenous risk outstanding with respect to interest rate risk. Any cut would be a positive to the business.

Operator

[Operator Instructions]. Our next question will be coming from Robert Dodd of Raymond James.

Robert James Dodd
Raymond James & Associates, Inc., Research Division

Sorry about the background noise. It feels kind of like weeding it down towards half of my questions for the last few quarters, but Lugano. So a couple of quarters ago, I asked you if you thought it could hit 1/3 of total EBITDA this year, you said no. Well, it's a-third this quarter. Obviously, that's not a guarantee that it's going to keep growing as a share.

But the discussion point is -- I mean, again, the concentration issue is a great business, but it is such a big driver of your growth and a big consumer of cash. I think it was around $71 million in operating cash flow consumption in the first half. So to fund the accelerating growth, you talked about it last quarter, but can you give us update on what your thoughts are on how you can continue to maximize the performance and the returns at Lugano while not having it just dominate all the financial needs of the platform?

Elias Joseph Sabo
Partner & CEO

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Yes. I mean, Robert, it's -- we talked about this last time. It's kind of a high-class problem because the return on invested capital is so abnormally high here. From a capital allocation standpoint, it's really hard to ignore the request for additional capital because we can't direct it in an alternative matter and get a better return. And so I think that leads us to want to continue to fund this, notwithstanding the risk that you're highlighting, which is it's becoming more concentrated in the portfolio. And it is like any hyper growth business that has a capital need to it, it is a capital consumer while it's in this massive growth phase.

I mean if this thing slowed down to a 20% growth business, it would be a really good growth cash flow producer. And if it grew at 3% or 4%, it would produce a ton of free cash flow. It's just happening to grow at 40%, 50%, and that causes our capital -- the capital requirements to be quite substantial. I think it really is kind of strategically how we think about the asset.

I think funding it needs, as long as it is a kind of subsidiary of us, is important, and it is important to the value creation of CODI. And it's important to Lugano reaching its maximum value potential as well. So I think there isn't really an alternative to fund the capital that they can wisely put to work with these type of returns. Clearly, if that breakdown in return on invested capital happens, then everything gets reevaluated.

But if you say that that's sort of a status quo, then we will continue to fund that. I think what it points to is given the differential in growth rate and it is growing so much faster than the rest of the portfolio, the third -- 33% concentration it represented in the quarter is likely only going to grow if that differential continues, which we would expect it to. And so in the next couple of years, it's going to become a bigger part of CODI unless we do something creatively with it. And I would say that could be anything from a divestiture, which clearly, that is part of our strategy, and we've done that historically with our assets, to kind of continuing to own it and financing it in a more creative way.

And I can think of like FOX as an example of how we own the business and creatively financed it through taking part of it public and then having the -- its own access to capital markets or debt markets wherever it could participate. And that was a win-win because it lowered their cost of capital. We still own the big piece. So as their majority owner in the beginning, kind of was an overall weight -- it was overall reduction in our WACC by continuing to own a majority of that business. So there's some options that we have.

And by the way, I just point to 2 things we've done in the past. We're thinking about a plethora of options, of financing and ways in this business over the next couple of years to both manage risk and obviously get the best return for our shareholders. But suffice to say, it is top of mind for us as well and we recognize the high-class problem that has come from a company that is growing this rapidly and now represents kind of a big cap -- or a big concentration with such a large capital need.

Robert James Dodd
Raymond James & Associates, Inc., Research Division

Got it. Understood. It is really a high-class problem. So they kind of tie to that, I mean, you talked about the health care that you might be considering doing a more build strategy, i.e., making a smaller acquisition. Obviously, if you had done something larger on health care, all hypothetical obviously, that would actually reduce the Lugano concentration.

So if your aim is something smaller in health care, when if you enter that, does that actually accelerate the need to find a solution? I mean, Lugano is not a problem, right, but to find some kind of creative way to manage the diversification in health care is going to hype the value be it a small add-on than might have been the case you thought a year ago.

Elias Joseph Sabo
Partner & CEO

Sure. And that's sort of door #3 that also exists, which is we do enough acquisitions, you've identified health care, but that's only 1 of the 3 verticals that we invest in. So it could be another consumer business. It could be another industrial tech business that we're looking at or just broadly, I mean, the teams are out day in and day out, Robert, looking aggressively for acquisition candidates. And as we are

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starting to see some green shoots, I think there are opportunities that are going to come about to deploy capital. That clearly is a -- something that will diversify Lugano -- diversify CODI more and bring Lugano's concentration down. So that's the third way we can do it.

Clearly, balancing there is the leverage. And so kind of access to capital markets becomes important, there's a lot of factors that are in it. But I wouldn't focus too much on the fact that we're maybe looking at some smaller health care deals. We're also looking at health care deals that are larger. It just so happens that in that vertical, we would start slightly smaller than where we will in our industrial and our consumer verticals. But we would just be just as happy to do a $500 million deal in the health care market as we do in a consumer or an industrial. But if we're -- do a $200 million deal, we will start there as well. And that was sort of the only point I was making earlier. But yes, we are looking to acquire and do so prudently without overusing kind of leverage on our balance sheet. So we're walking that fine line.

Operator

And our next question will be coming from Matthew P. Howlett of B. Riley.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

Just to be clear, I think you said last call that you'd be comfortable taking leverage up 1/2 turn, 3/4 of a turn temporarily. Do you still feel the same if you found something you really wanted?

Elias Joseph Sabo
Partner & CEO

Yes. And I would say, Matt, given BOA and PrimaLoft and their return to growth, I mean these are just really outstanding businesses. And we kind of I think all went through a traumatic period where inventory destocking was kind of a generational thing. Nobody anticipated the events that COVID would unleash, including sometimes sell-in being half of what sell-through is. And it really had to reset all of our expectations lower for a period of time. But these are great businesses that have good industries with growth, and they are taking share, and they are really well protected.

And so even if the macro economy weakens a little bit here or there, those businesses can grow right on through it. And they've proven the ability to do that in normal times where inventory changes aren't so wild. And so we look at Lugano which is, frankly, totally disconnected to the macro economy. Unless there's another great financial event that occurs, I mean, this is a company that deals with a clientele that is very unique. And it is a very disruptive business in a massive industry that they've got a tiny amount of share. So it's a really good formula to be able to grow outside of general macroeconomic conditions.

And so as we said before, you look at those 3 businesses, and they are poised to grow not only now, but in '25 and beyond. It's just such a good stable base that you can get comfortable with to then take on a little bit more balance sheet leverage and be comfortable with that. So maybe a long-winded answer of saying, yes, we remain confident for the right asset that we could take leverage up 1/2 to 3/4 of a turn.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

That's incredible, you have that loyalty, the consumer loyalty that gives you that much confidence. So it's really -- they really are special companies. So on that note, I mean, just you talked about new products at the Honey Pot. I mean looking at 2025, you talked about maybe new -- some new technology at Velocity, new products in Honey Pot.

Anything -- can you go into a little more detail on what could happen or what could -- the impact could be on '25? And is there anything else? Any new -- anything else in the other subsidiaries to flag in '25? Just when we think about '25, something -- stuff being rolled out in the subsidiary. So anything to highlight and go more in detail with?

Elias Joseph Sabo
Partner & CEO

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In general, all of our companies are working on -- I mean, we work really closely with our businesses, and everybody has product road maps. If it's a consumer business, there are very detailed product road maps and new product introductions that are coming out and how we're going to execute and be more profitable. We give you a little bit of a preview quarterly, and we talk about some of the highlights in our businesses. But I could just tell you that across all of our consumer businesses, they are all working on innovative products to roll out. In our industrial businesses, we're trying to figure out how to, again, continue to innovate.

Can we become more efficient? Can we lower our cost and deliver better value to our customer and capture some of that for ourselves? Can we create new solutions that are environmentally friendly and differentiated? It would be too much to go into detail in all of our companies. What I can tell you are kind of driving daily mission in our company, and when we come in every day and what we talk to our companies about is what are you doing to maintain your source of innovation and competitive lead over our competition that's out there? And they focus on this on a daily basis. It's a tone that's set at the top. It starts with me. It goes through Pat and everybody at Compass and down through all of our portfolio of companies.

So I will tell you, the innovation engine is stronger within our organization today than it's ever been, and that's why we feel that we're poised to not only meet, but potentially exceed here our core growth rates over the next few years disconnected from the global economy because we just put up nearly 20% growth and one of our industrial businesses had a really difficult quarter. That's a tough thing to do. We have some great businesses that are driving that, and that gives us a lot of really good hope and not only hope visibility into '25 and beyond that this company is set up to really have these kind of growth rates for an extended period of time.

Matthew Philip Howlett
B. Riley Securities, Inc., Research Division

To tell you, it's an incredibly strong statement. I really appreciate the confidence with the outlook. I guess just to throw in, I mean, on the Honey Pot, that was growing at -- well, you bought it at an incredible rate. I know you ran into a little bit of a speed bump, but you still feel that's -- I think that was growing at like a 52% CAGR. I mean, it's something incredible. Do you still feel like it's a double-digit grower long term or mid double-digit growth?

Patrick A. Maciariello
Partner & COO

Yes. I feel like it's a double-digit grower long term. And I think we'll get back on that trajectory. The brand is authentic and they're really trying to destigmatize any issues around feminine care, and there is a real mission-driven aspect to them that we respect and we think the market and customers will reward.

Elias Joseph Sabo
Partner & CEO

Matt, it's not unusual in the first integration period. When we buy a company, there's a lot that these guys have to go through to become part of the CODI family. And as we CODI-ize a company, as we say, internally, the first part of that is there's a lot of reporting and other obligations that inevitably consume a lot of resources. We have to make some investments there. And before you start to get the benefit of some of the productivity that results from that, you're starting to have the resource drain and the cost that go in. So it is not abnormal for us to have a period where growth is a little bit slower and then to see that start to accelerate, especially as we get more of an infrastructure build in a lot of the companies that we partner with for long-term growth, and that starts to manifest.

And we would expect by putting more investment in that their growth rates can pick up from where they were. Now Honey Pot was such a small company, its growth rate, it's the law of large numbers or, I guess, the reverse here. So it was coming off such a small base. You're not going to get a 40%, 50% growth rate. But we're putting in a lot of infrastructure investment right now so that this company can be a double-digit grower consistently under our ownership. And given its innovative products, given the TAM that it has, given its current market share and given the strength of the brand and perception from

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its consumer, there is nothing that suggest that it can't kind of be a double-digit grower for an extended period of time.

Operator

There are no more questions. At this time, I would like to go ahead and turn the call back over to Mr. Elias. Please go ahead.

Elias Joseph Sabo
Partner & CEO

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 does conclude today's conference call for today. Thank you so much for joining. You may disconnect.

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