

# Compass Diversified NYSE:CODI

## FQ3 2024 Earnings Call Transcripts

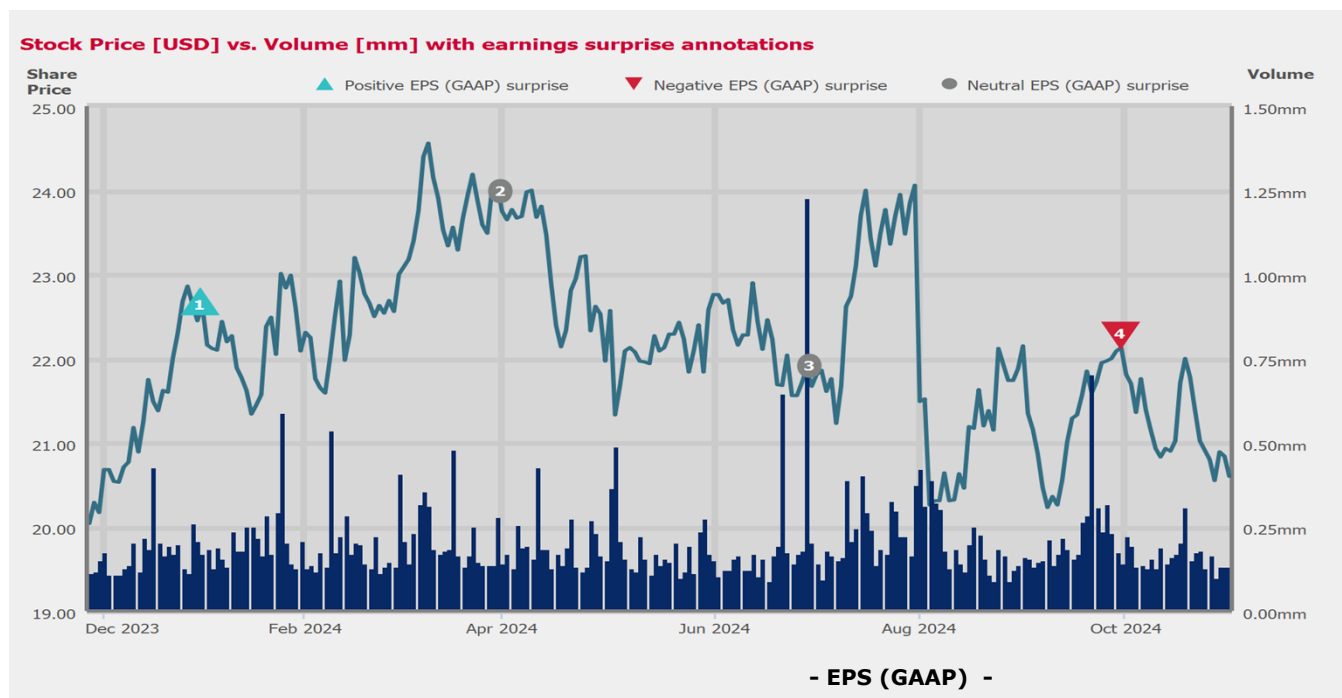
Wednesday, October 30, 2024 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2024-			-FQ4 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
<b>EPS (GAAP)</b>	0.20	0.08	▼ (60.00 %)	0.26	0.21	1.02
<b>Revenue (mm)</b>	571.68	582.62	▲ 1.91	611.13	2249.68	2420.79

Currency: USD

Consensus as of Oct-17-2024 5:14 AM GMT



	CONSENSUS	ACTUAL	SURPRISE
<b>FQ4 2023</b>	0.03	1.70	▲ 5566.67 %
<b>FQ1 2024</b>	0.18	(0.02)	NM
<b>FQ2 2024</b>	0.18	(0.45)	NM
<b>FQ3 2024</b>	0.20	0.08	▼ (60.00 %)

# Table of Contents

Call Participants	.....	3
Presentation	.....	4
Question and Answer	.....	9

# Call Participants

## EXECUTIVES

**Elias Joseph Sabo**  
*Partner & CEO*

**Patrick A. Maciariello**  
*Partner & COO*

**Stephen Keller**  
*Executive Vice President & CFO*

## ANALYSTS

**Lawrence Scott Solow**  
*CJS Securities, Inc.*

**Matthew Butler Koranda**  
*ROTH MKM Partners, LLC,  
Research Division*

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

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

**Unknown Analyst**

## ATTENDEES

**Cody Slach**  
*Gateway Group, Inc.*

# Presentation

## Operator

Good afternoon, and welcome to Compass Diversified's Third Quarter 2024 Conference Call. Today's call is being recorded. [Operator Instructions]

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

Mr. Slach, you may begin the conference.

## Cody Slach

*Gateway Group, Inc.*

Thank you. and welcome to Compass Diversified's Third Quarter 2024 Conference Call. Representing the company today are Elias Sabo, CODI's CEO; Stephen Keller, CODI's CFO; and Pat Maciariello, COO of Compass Group management.

Before we begin, I would like to point out that the Q3 2024 press release, including the financial tables and non-GAAP financial measure reconciliations for subsidiary adjusted EBITDA and adjusted EBITDA, adjusted earnings and pro forma net sales are available at the Investor Relations section on the company's website at [compassdiversified.com](https://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. Unless otherwise noted, references in these remarks to company-specific financial measures relate to the third quarter of 2024 and references to period -- references to period-to-period increases or decreases in financial metrics are year-over-year. 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. 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 political and economic environment, disruption in the global supply chain, labor disruptions, inflation, risks associated with the company generally due to natural disasters or social, civil and political unrest 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. Today, I am pleased to announce we delivered another strong quarter. In Q3, we saw our combined revenue grow double digits, and our adjusted EBITDA grew by over 25% versus the third quarter of 2023. In fact, our Q3 adjusted EBITDA of \$114 million representing new quarterly record for CODI and is a byproduct of our strong business model and our long-term value creation strategy.

Based on performance to date, we are raising our full year guidance for 2024, and we believe we are well positioned into 2025. Before I hand it over to Pat and to provide more details about both our Q3 performance and our full year outlook, I wanted to take this opportunity to provide a little more color on both our strategy and our current operating environment.

Despite ongoing economic and geopolitical uncertainty, the North American consumer, especially the more affluent consumer, appears to be holding up well. We are encouraged by recent interest rate cuts and the continued slowing of inflation over the last several quarters. We think this supports a stable outlook for the economy.

Obviously, geopolitical uncertainties driven by the U.S. election and conflicts in the Middle East and Russia create some incremental risk that we are monitoring and will manage as required. We believe that our diverse mix of businesses provides us with useful insights into the underlying market outlook.

In order to better gauge both the economic outlook and the strength of our businesses, we have recently developed a proprietary indicator that we call the CODI Momentum Index. This index uses data from our subsidiaries, including the last 12 weeks of both bookings and sales to help us identify shifts in market sentiment. At the start of the year, we saw a momentum index of 1.02. And as of the end of last week, we had a momentum index of 1.04. We believe this reading is consistent with a stable economic outlook for Q4 and into 2025.

As I mentioned, our positive results this past quarter demonstrate the strength of our business model and our long-term strategy. Innovation and disruption are at the heart of CODI. And over the last few years, we have begun to codify our goal of owning and actively managing companies that demonstrate our innovative and disruptive spirit. These are high-growth middle market companies with a sustainable competitive advantage that are poised to gain share in active market -- attractive markets.

Partnering with and empowering our subsidiary management teams to realize their vision is a key part of our value creation strategy. We don't just provide capital. We provide strategic and active support and a long-term orientation. We work with our management teams to ensure that our businesses have the right strategy, processes and talent as they drive outsourced growth through innovation superior execution and a focus on the long term.

I am proud to note that just yesterday, we were awarded Inc. Magazine's Founder-Friendly Investor Award. a testament to our collaborative and bespoke approach to working with our businesses and management teams. Our collaboration with our businesses goes well beyond traditional value drivers. For example, the work of our internal audit team often happens outside the spotlight, but creates tremendous value. As you know, we typically acquire middle-market companies that have varying levels of financial processes and controls in place.

Our internal audit team works very closely with our subsidiaries to systematically review and improve our subsidiaries' financial processes and controls, creating both better outcomes and more confidence. This positions our businesses to scale and ultimately drives exceptional value for all stakeholders.

Consistent with our long-term strategy, in the third quarter, we raised more than \$17 million of preferred stock capital. We plan to continue to raise capital through the issuance of preferred stock as we believe this lowers our long-term cost of capital while maximizing our financial flexibility.

We also continue to focus on opportunities for capital deployment. Our goal is to be active but disciplined as we look for the type of companies we want to own and manage. While the M&A market remains somewhat muted, we continue to cultivate relationships with founders, entrepreneurs, bankers and private equity companies in order to position us to buy great CODI like companies at appropriate prices.

We are confident that we can be the buyer of choice for innovative businesses that have strong business models and need long-term capital as well as strategic and active support to unlock value.

In the meantime, we continue to invest in our subsidiaries. On October 1, Altor completed the acquisition of Lifoam. This addition accelerates Altor's long-term strategy, expands its capabilities and we expect will support faster growth as Altor partners with its customers to bring advanced cold chain packaging solutions to the market. Each of our businesses continues to explore inorganic opportunities to drive long-term value creation, and we stand ready to support their growth.

Lastly, on October 16, we announced a new \$100 million repurchase program that authorizes us to opportunistically repurchase common shares throughout the balance of 2024 and beyond, subject to extension of the program by our Board. This program indicates that we do not believe our current share price reflects the intrinsic value of our business and it further indicates our confidence in CODI's strategic plan and our continued growth prospects.

Our performance in the quarter was not an accident. It is the direct result of the execution of our strategy. I want to take a moment to thank the outstanding team here at CODI who worked tirelessly to bring our vision to life. I also want to thank our subsidiary management teams and employees for their hard work fostering innovation, driving exceptional results and exceeding expectations.

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

**Patrick A. Maciariello**  
*Partner & COO*

Thanks, Elias. To reiterate, it was another successful quarter and our business has continued to exceed our expectations. Over the last few quarters, our confidence in our companies has increased, and we believe we have the right approach in place to exceed our 2024 goals and set us up for a strong 2025.

I will start with our Branded Consumer segment, where for the year-to-date period, pro forma revenues increased by 10.3% and pro forma adjusted EBITDA increased by 27% versus the prior year period. Our consumer vertical continues to surpass our expectations and growth is particularly strong in areas where we serve the most affluent customers.

Lugano and BOA posted exceptional quarters. And PrimaLoft and the Honey Pot Company also performed very well. We believe growth will continue to be strong in each of these businesses, though at Honey Pot, we believe there may be some lumpiness on a quarterly basis as we continue to invest in the brand to solidify its position in the market and drive long-term share growth.

Within our Industrial segment, on a year-to-date basis, revenues declined by 4% and adjusted EBITDA declined by 6.1%, respectively. The decline in the quarter was driven primarily by headwinds at Outdoor Solutions, which continues to face challenges at several of its cold chain distribution partners. We believe Altor is now offering a solution that can address the changing needs of the industry, and we believe that performance at Altor will stabilize and the company will return to growth in the midterm.

In addition, we're very optimistic about the opportunities presented by Altor's recently completed acquisition of Lifoam. We're expecting approximately \$7 million in integration costs over the next 5 to 6 quarters as the company extracts what we believe will be considerable synergies from the transaction.

Arnold had another strong quarter, and we believe it will finish 2024 with solid performance. Included in this quarter's results were approximately \$900,000 of onetime move costs as the company transitioned its Illinois operations to a new state-of-the-art location to better facilitate growth. In Q4, we expect these costs to total approximately \$7 million, excluding capital investments, as the company completes this strategic transition.

For both Altor and Arnold, we intend to call out the specific onetime costs over the next several quarters to provide a better perspective of core business performance.

Once again, we are very pleased with our performance this quarter, and we are excited to close out 2024 and continue to grow in 2025.

I will now turn the call over to Stephen so he can provide more specifics about CODI's consolidated financial performance in the quarter and outlook for the full year.

**Stephen Keller**

*Executive Vice President & CFO*

Thank you, Pat. In the third quarter, we delivered consolidated net sales of \$582.6 million, representing an increase of 11.8% over the prior year. Normalizing for the impact of acquisitions, our pro forma sales grew 6.6% in the quarter. As mentioned, growth in the quarter was primarily driven by branded consumer businesses with Lugano, BOA, PrimaLoft and Honey Pot, all delivering double-digit growth. This growth was partially offset by the divestiture of Velocity's Crosman airgun business as well as more modest growth in our industrial businesses.

Our consolidated net income in the third quarter was \$31.5 million, which compares favorably to a net loss of \$3.8 million we recorded in Q3 of 2023. Adjusted EBITDA in the quarter was \$114 million, representing a 28% increase over the same period in 2023. While our year-over-year performance benefited from the acquisition of Honey Pot, growth in our adjusted EBITDA was primarily driven by strong operational performance across most of our subsidiaries, with Lugano, BOA, PrimaLoft and Arnold, all significantly expanding adjusted EBITDA margins in the quarter.

Corporate costs and management fees were \$22.7 million in the quarter. This represents an increase of greater than \$2 million over the prior year and a sequential increase of \$1.8 million from Q2 of 2024. The increase -- this increase was driven primarily by onetime costs associated with our recent CFO transition. Excluding these nonrecurring costs, total corporate costs and management fees were down both year-over-year and sequentially. Adjusted earnings in the quarter were \$48.7 million, which represents a 65% increase over Q3 of 2023.

Turning to our cash flow. In the third quarter, we used \$29 million of consolidated cash flow from operations. Our cash usage was primarily driven by the extraordinary growth of Lugano, where we used around \$60 million in cash in the quarter to support this highly profitable, fast-growing business. Outside of Lugano, our other subsidiaries generated greater than \$30 million in operating cash.

In terms of capital expenditures, we invested \$15.6 million in the quarter, an increase of \$5.7 million over the prior year period. Increase in capital investments was related to growth investments in our consumer businesses as well as the plant relocation in Arnold, which Pat discussed earlier.

Our balance sheet is strong, and we ended the third quarter with \$71.9 million in cash, and greater than \$480 million available on our revolver. Our total leverage ratio declined modestly to 3.68% in the quarter. It is important to note that subsequent to the end of the quarter, we deployed approximately \$140 million of cash to close the Lifoam acquisition. Overall, we maintained substantial liquidity and have the ability to increase our borrowings by an additional \$250 million.

We believe we are well positioned to both fund the growth of our subsidiaries as well as act on attractive acquisitions as they become available.

Turning to our full year outlook. As Elias mentioned earlier, based on our strong Q3 performance and the momentum we see across our businesses, we are raising our full year guidance. We now expect our consolidated pro forma subsidiary adjusted EBITDA to be between \$510 million and \$525 million. This is inclusive of Honey Pot as if it was owned from January 1, 2024. Increase in our full year guidance will primarily come from an increase in our branded consumer vertical, which we now expect to deliver adjusted EBITDA between \$390 million and \$400 million. Adjusted EBITDA for our Industrial vertical is now expected to be between \$120 million and \$125 million for the full year.

On a consolidated basis, we expect our adjusted EBITDA to be between \$420 million and \$435 million inclusive of corporate costs and management fees of around \$90 million. Our full year adjusted earnings are expected to be between \$155 million and \$165 million. Obviously, this outlook does not include the impact of any potential acquisitions or divestitures.

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

**Elias Joseph Sabo**

*Partner & CEO*

Thank you, Stephen. Before turning it over to the Q&A portion of the call, I'd like to highlight that we will be hosting our Investor and Analyst Day in New York City on January 16, 2025; and where we will be showcasing our diverse subsidiary businesses and we'll share more about our strategic positioning and our playbook for driving long-term shareholder returns. You can expect more details in the coming weeks, and I look forward to seeing all of you there.

With that, operator, please open the lines for Q&A.



# Question and Answer

## Operator

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

## Lawrence Scott Solow

*CJS Securities, Inc.*

I guess, first question, just on the guidance, narrowed up and then raise a little bit as well. It looks like on the industrial piece, just tweaked upwards a little bit. I guess that's primarily for the Lifoam acquisition. And then on the branded side, is that mostly Lugano, or any thoughts on that?

## Elias Joseph Sabo

*Partner & CEO*

Yes, Larry, it's Elias. On the consumer side, -- it's a little bit broader than Lugano. I would say the guide includes BOA performing better than anticipated. Honey Pot had a really strong third quarter. We do anticipate investing substantially in marketing in the fourth quarter, but it's still going to expect it to deliver year-over-year growth. So that is kind of on track and where we expect. PrimaLoft is turned and doing a little better than expectations. So it's broader than just Lugano and your point on Industrial is correct. That is due to Lifoam.

## Lawrence Scott Solow

*CJS Securities, Inc.*

Got you. And I like the momentum index, I usually kind of ask you a question in those words, and you've kind of quantified it now, which is kind of fun. I guess the question I have one or two and then it was -- so it's a little bit up now.

I guess, was there somewhat of a downturn at some point this year? Has that kind of just trending in the last few weeks of that number in the last couple of months kind of just be a little bit back up? Maybe a little bit of semantics, but just curious that there's been any movement in between January 1 and recent.

## Elias Joseph Sabo

*Partner & CEO*

Yes, Larry, it's interesting because on the consumer side, it's held relatively stable throughout the year, which I think it indicates what we were talking about the consumer, especially the more affluent consumer that we touch has held up remarkably well.

We have seen a little bouncing around on the Industrial. I would say there was a general trending down over the first 6 months of the year, 6, 7 months. Somehow miraculously in August and September, we saw that take almost a V-shaped turn back up. And then the Industrial business has sort of weakened back a little bit.

And so it's gyrated a little bit around. It did correlate to a lot of the better economic readings we saw over that time in late Q3. It has ticked down a little bit in October. So it feels like there was a little bit of momentum maybe around interest rate cuts, maybe that freed up some order flow that happened, especially on the industrial side of the economy. Now that feels like it's sort of rein back in a little bit.

## Lawrence Scott Solow

*CJS Securities, Inc.*

Got you. Okay. Great. And I just wanted to -- just one company-specific question, and then I'll leave it up to someone else. Just on Lugano sort of the highest of the high end in luxury and clearly another amazing quarter. I think this business has been incredible. Just do you see this continuing?

And I guess my other specific question, has there been any hesitation or any impact thoughts on potential changes in capital gains tax, does that potentially impact the business?

And I guess, a more broader question without getting too political, just across your businesses, does the election, could that have any impact on you guys on a kind of broad brush basis? Then I'll leave it at that.

**Patrick A. Maciariello**

*Partner & COO*

Larry, it's Pat. I will start with just a little bit more color on Lugano and then I'll let Elias handle the political question.

But I think the growth at Lugano continues to be broad. We don't anticipate potential changes in capital expenditures to -- or excuse me, and cap gains tax rates to have an effect. It continues to be broad geographically. The number of transactions as well as the transaction side continues to increase. And we continue to grow geographically. We just announced and it is in several papers that we'll be opening on the Gold Coast in Chicago. We have a great location there that we're excited about, and that will be sort of the first quarter, maybe spring of next year, and we're considering other locations.

And the new locations are doing well. I mean, we're having pretty good success internationally after opening our London salon. So, everything is kind of doing really well at Lugano and we are excited to continue to invest in the business. .

Elias, do you want to speak on the election results?

**Elias Joseph Sabo**

*Partner & CEO*

Yes. I don't know that we have any insight other than to say how different policies could affect us. As you know, being -- selling consumer goods, we do import a lot of that product. Some of that product comes from Southeast Asia and some particularly out of China.

If there are 10% to 60% tariffs that get enacted on all of our trade partners, clearly, that's going to create some level of disruption, Larry. There is no way that any company can absorb those kind of tariff increases. So my sense is this gets pushed through to additional pricing in the marketplace is inflationary and likely reduces consumption unless there's some tax decrease that can offset that increase in costs that are going to be pushed through.

So I think that could be a potential that we are clearly looking at. But other than that, I don't think there's been a lot of talk about policies outside of potential tariffs that would have too major of an impact on our operating companies.

**Operator**

[Operator Instructions] And the next question coming from the line of Matt Koranda from ROTH Capital.

**Matthew Butler Koranda**

*ROTH MKM Partners, LLC, Research Division*

Just wanted to start off with Lugano. Maybe any way to unpack the kind of the key drivers of growth there? I mean just continues to sort of defy expectations on the top line?

And I have a question on the margins that I'll get to. But curious if maybe you could just parse out or help us understand qualitatively like existing salon growth versus what you're seeing from the new salons in terms of contribution? Anything to call out on like average order values that could be helping you there? Just kind of wanted to get a better sense of the drivers there.

**Patrick A. Maciariello**

*Partner & COO*

Sure. So I'm only going to say that all salons did increase year-over-year. I'm not going to kind of touch on kind of salon by salon or area by area where the growth was. But these organic salons or the existing salons continue to grow and performed really well.

We do continue to see a march up in sort of our average transaction value which is driving a decent chunk of growth. We also see an increase in our number of transactions per quarter. So it's a little of each, if that makes sense. And I'm sorry, I can't be more in-depth than that. But it's a little of each.

And really, it goes to -- we believe Lugano fundamentally has a different business model, and we believe it's disruptive. I mean we are offering more value to the consumers than are any of Lugano's competitors. And we believe that that's important, whether you're dealing with -- whether you're dealing with people any demographic, right? And so that's important for people of the highest demographic as well.

We're creating long-term relationships and we're really allowing them to look at jewelry as more of a store of wealth., So we think it's a combination of all those things, right? And clearly, you see our investments in inventory. You need to have diamonds in order to sell diamonds, right? And that's part of what we're doing as well. And we're getting turns on that, and we're getting a very good return on our investment. But it's really a combination of all of those, Matt.

**Matthew Butler Koranda**

*ROTH MKM Partners, LLC, Research Division*

Yes. Okay. Now that's fair. It sounds like balanced growth there. That's great. And then just on the incremental margins, I think historically, you guys have spoken to \$1 of growth gets you \$0.30-plus of incremental margin on the EBITDA line at Lugano. Maybe this quarter was quite a bit in excess of that. I'm just curious if there was anything unique about the third quarter that drove the profitability there at Lugano or anything else to call out so we can understand sort of the incremental margins on a go-forward basis?

**Patrick A. Maciariello**

*Partner & COO*

Yes. I mean as we grow and as we get more scale and as we add more capabilities and more talent and management, we're clearly buying at least as effectively, if not more effectively, number one.

And number two, I'm not sure if this quarter. I would not want to take this quarter's margin to sort of straight line them over the next 4 quarters, right? This could have been slightly higher than average, not materially, but slightly higher than we'd expect going forward. And I will just point out Q4, we think, is going to be a great quarter. There are marketing events as well in Q4, but we think we'll grow well beyond any increase in costs.

**Matthew Butler Koranda**

*ROTH MKM Partners, LLC, Research Division*

Okay. Got you. And then maybe just one broader question. I sort of always asked on this call in some shape or fashion, but maybe Elias, just thoughts on the M&A landscape and what you're seeing in terms of deal flow these days?

And then I noticed maybe, Stephen, balance sheet maybe has a little bit less capacity in the near term to do something large given the Lifoam acquisition and then maybe the desire to deploy a little bit on the \$100 million buyback? And maybe just talk about the -- how we kind of balance sort of the desire to add to the portfolio versus the stock, which is seemingly very cheap right now.

**Elias Joseph Sabo**

*Partner & CEO*

Yes. So Matt, on the -- remind me your first question again? And then I'll talk about.

**Matthew Butler Koranda**

*ROTH MKM Partners, LLC, Research Division*

Was just the first question was just M&A landscape and deal flow.

**Elias Joseph Sabo**

*Partner & CEO*

Yes. And then we'll talk about the balance sheet. So -- and the deal flow has been relatively muted. And it's been that way for a couple of years now. I know we sound like broken records.

One of our -- as we said in our script, we want to be active, but we're also going to be really disciplined here. And the types of companies that we're chasing down, which are consistent with what you've seen us buy coming out of COVID, right, like BOA, PrimaLoft and Lugano. These are very innovative businesses. Their growth rates are much stronger. They generally have a lot of IP protection. Those companies, Matt, just have not been trading in the marketplace.

And we're looking everywhere we can. We're trying to be catalysts with entrepreneurs, directly approaching them. First, we had, obviously, the rate environment and tight policy, which created a reduction in deal flow. We have the worry that you may have a recession that ends up hitting and now everybody is getting comfortable with the soft or no landing. And that has really just made the M&A markets very weak.

Now you have a presidential election that's coming up, and that's sort of frozen the market completely on the M&A landscape. So we're hearing there are going to be a number of transactions that come forward after the election. I think regardless of the outcome, as long as it's a peaceful outcome and transition of power, I think that is going to free up a lot of deal flow. And we're hearing the bank pitch activity has been extremely strong.

So I think there's going to be more activity coming into 2025. But I just want to reiterate, we will be very disciplined to the types of companies that we want to buy. We think that the opportunity cost is much greater to act on something that's not consistent with our strategic mandate.

In terms of the balance sheet, we continue to remain under 4x leverage. We're a little bit outside of the top end of our leverage parameter, which is 3.5x, it's not materially outside of that. One of the things that has occurred over the last half a dozen years, is we've moved from a portfolio that grew generally down at GDP or 0% to 3% to now a portfolio that is growing at kind of high single digit to this year's low double-digit rates.

And I think that supports natural deleveraging better than we have ever had before. Depending on Lugano's growth rate, clearly, depending on if capital needs that alters sort of the balance sheet equation, but we're now at a point where we're generating well north of \$100 million of retained cash on an annual basis and that's something that we can use to support, whether it's the buyback, whether that's into M&A opportunities, supporting capital deployment into Lugano.

Clearly, the growth of the business is a deleverager just because the denominator is getting larger in that equation. And we would expect that to continue not only in Q4 but into 2025 as well.

So, we're comfortable with where our leverage is, given all of those dynamics, which, frankly, are in the best position this company has ever been in, in terms of growth, cash flow before working capital investment, you name it.

In terms of where we are capacity-wise relative to our full revolver commitment, I'm very confident and we talk with our financing partners all the time, that there are available capital in different parts of the market, whether that be term loans, we have a Term Loan A outstanding right now. That is something available to tack on to. The term loan B market is available to us.

So we have a lot of secured lending capacity that we can move around revolver and open up additional liquidity. We can enter into the bond market where we continue to trade extremely well relative to what our rating is. So we feel very good about our balance sheet and all of the capacity that we have.

**Matthew Butler Koranda**

*ROTH MKM Partners, LLC, Research Division*

Copyright © 2024 S&P Global Market Intelligence, a division of S&P Global Inc. All Rights reserved.

Okay. Thorough as always. I'll leave it there.

**Operator**

And next question coming from the line of Matthew Howlett from Jefferies.

**Matthew Philip Howlett**

*B. Riley Securities, Inc., Research Division*

Great quarter. Could you talk about just the bullwhip and supply chain impact on various portfolio companies? And when that might sort of unwind and become a tailwind just in terms of the destocking trends that we've seen?

**Patrick A. Maciariello**

*Partner & COO*

Sure. This is Pat. I don't know as to whether or not when it will become a tailwind per se. I will say or if it will. I mean, I don't -- sometimes you don't want to have too much of a tailwind from where you are now because that means you're overstocking at retail and that sets you up for -- that sets you up for issues in the future.

Portfolio-wide, we think we're kind of an equilibrium now if that makes sense. We don't think we're overbuilding. We don't think we're kind of draining supply within the channel. Portfolio-wide, I would say we generally feel like we are in those sort of early supply chain businesses, we generally feel like we are sort of producing in a manner that's roughly equal to consumer demand.

**Matthew Philip Howlett**

*B. Riley Securities, Inc., Research Division*

Okay. That's helpful. Great. And then could you just talk about how you're thinking about the dividend at this point? Obviously, leverage has been fairly consistent, and you're out earning it by a large margin, but just how you're thinking about dividend payments going forward?

**Elias Joseph Sabo**

*Partner & CEO*

Yes. As we've said publicly in the past, our Board makes our decision on the dividend. We paid a dividend since coming public every quarter that we've been public, and that is the current position of the company is that we are a dividend payer, and we will be, unless there is some change in strategic plan, which is not being considered right now.

**Operator**

The next question coming from the line of Robert Dodd from Raymond James.

**Robert James Dodd**

*Raymond James & Associates, Inc., Research Division*

Congrats. Going back to that -- the M&A landscape kind of issue. I mean maybe a CODI M&A optimism index question. I mean rather than like over the next quarter, has been very muted. I'm hearing the same thing like pipelines are building, et cetera. But what's your level of optimism over say, the next 12 months you think the market's going to be conducive to you finding the kind of deals you want?

I mean going into an auction process for a highly competitive health care company might not be ideal for you, right, because that's not the kind of business as you approach you normally take. But what's your view on over an extended period that the market is going to be conducive to something happen?

**Elias Joseph Sabo**

*Partner & CEO*

We're very optimistic right now, Rob. We think the M&A markets, which have been subdued, as I said for a couple of years, really can only stay there for so long. Eventually, people do need to move on. There's a

state planning for entrepreneurs and tax planning that ends up occurring. There's private equity fund lives that end up coming into a kind of a situation for them or there's just the desire for them to exit so that they can have realizations to move forward.

That -- so I think there is going to be a lot of forces for why sellers should be starting to come back into the market. Everybody has been really hesitant because nobody wants to bring an A+ asset to market and be the first one with price discovery and fall flat on your face. So it's created a catatonic kind of seller market right now.

With interest rates coming down, that first 50 basis point move, I think helps. If the fed is continuing to move monetary policy looser that's going to help these type of assets. We're already seeing lending start to come back and the leverage multiples start to come back in the marketplace. So the ingredients are in place that give us a lot of optimism, Robert, that next year is going to be a pretty good bounce back, and we should be able to transact against the company of the ilk that we want to buy.

**Robert James Dodd**

*Raymond James & Associates, Inc., Research Division*

And then I got to ask the requisite Lugano question. I mean on store openings next year, I mean, what -- do you have any preliminary -- I mean it takes a while to open them, right? I mean if you're open one by the middle of next year, you've got to have the location already picked out, right?

So what's kind of the -- any color on how many you think might be open next year? Do you think you'll do a second international? I mean London seems to be doing quite well, but nothing has been -- you can sell internationally without having to sell, obviously. But do you think there's going to be more international footprint expansion and expand the potential customer base even further, right?

**Patrick A. Maciariello**

*Partner & COO*

Yes. So the Board hasn't -- the Board of Lugano, and we haven't reviewed with them sort of the strategic plan for 2025. That being said, as you would expect us to and as you want us to, we always have irons in the fire. And there are several locations that we're evaluating any -- not at any point in time, but lately, and there are several locations now and one of the several is international and more than one of the several or not. Is that a good sort of summary.

I'd say we -- there is room for growth. We've identified a lot of markets that we think are attractive and within that this Lugano model would fit into. And absent something happening, we would envision incremental store openings next year or maybe 2. If I had to guess. I mean if I -- you want me to roll out a number, right? I mean, maybe 2 probably.

**Robert James Dodd**

*Raymond James & Associates, Inc., Research Division*

Sure, always want the number.

**Elias Joseph Sabo**

*Partner & CEO*

Sure. Sure.

**Operator**

And the next question coming from the line of Jonathan [indiscernible] from TD Cowen.

**Unknown Analyst**

This is Jonathan on for [ Lance ]. Just one question for me. With the decreasing of rates with -- it seems to be a good quarter and the raised guidance. How are you thinking about balancing the share buybacks, potentially acquisitions in 2024 as well as managing your debt? Like how do you prioritize it? Or does it change based on what's going on in the market at the time?

**Elias Joseph Sabo**

*Partner & CEO*

Yes. Jonathan, this is Elias. Our capital allocation is fluids. Clearly, we would like to retain capital to proceed against our strategic plan. And as we've said many times to the market, a strategic goal within our strategic plan is to hit \$1 billion of EBITDA. And we think that size and breadth of subsidiaries and end markets all the diversity that comes from that, it continues with our quest to lower our cost of capital.

So that is our strategic North Star that we constantly point to and internally generated capital as well as whatever we generate in the market through capital raising and through divestitures, our first goal would be to prioritize acquisitions that align with our strategic vision.

Now that being said, we cannot be immune to the stock price. And as our opinion of intrinsic value starts to deviate materially from the stock price, then it's incumbent upon us to put a floor in or at least use better capital allocation to buy back those shares because the return on that buyback is on a risk-adjusted basis, better than what we think we can get in the market by deploying against our strategic plan.

So I know that doesn't give you an exact answer. It's fluid. Our priority is to follow our strategic plan. That being said, at this level of discount, we are willing to step in and use a buyback and support the share price at this type of return, we think we would be getting on that capital that's being used.

I also want to point out one of the comments that I made in the script is that we raised \$17 million of preferred capital in the third quarter. We have also raised capital in the fourth quarter. We don't disclose how much until the following. That's preferred capital we raised in the fourth quarter so far before the window was shut in October.

We would anticipate as long as that product is available to us at reasonable cost, which it is right now, that we would continue to raise that as a form of equity capital that can be used to either invest in Lugano, it could be used theoretically to buy back shares, right? Money is fungible. So wherever the highest return on invested capital is. I can tell you, in our opinion, right now, nothing is as attractive as investing in Lugano, because the returns that gives are really exceptional.

And so that -- raising preferred can be there, I can buy back our stock. It can be part of the acquisition capital that we have to go buy new companies. That we view as a viable source or just general deleveraging. And so there is capital coming in the door through that means. And as M&A markets become more active for us on the acquisition side, we do think that there are some divestiture opportunities that we would continue to pursue as I continue to say, we march against our strategic plan.

**Operator**

Thank you. There are no further questions at this time. I would now like to turn the conference call back over to Mr. Elias. Sir?

**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**

Ladies and gentlemen, this concludes Compass Diversified conference call. Thank you, and have a great day.

Copyright © 2024 by S&P Global Market Intelligence, a division of S&P Global Inc. All rights reserved.

These materials have been prepared solely for information purposes based upon information generally available to the public and from sources believed to be reliable. No content (including index data, ratings, credit-related analyses and data, research, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions, regardless of the cause, for the results obtained from the use of the Content. THE CONTENT IS PROVIDED ON "AS IS" BASIS. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages. S&P Global Market Intelligence's opinions, quotes and credit-related and other analyses are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P Global Market Intelligence may provide index data. Direct investment in an index is not possible. Exposure to an asset class represented by an index is available through investable instruments based on that index. S&P Global Market Intelligence assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P Global Market Intelligence does not act as a fiduciary or an investment advisor except where registered as such. S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) and [www.globalcreditportal.com](http://www.globalcreditportal.com) (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

© 2024 S&P Global Market Intelligence.