

# Compass Diversified NYSE:CODI

## FQ3 2025 Earnings Call Transcripts

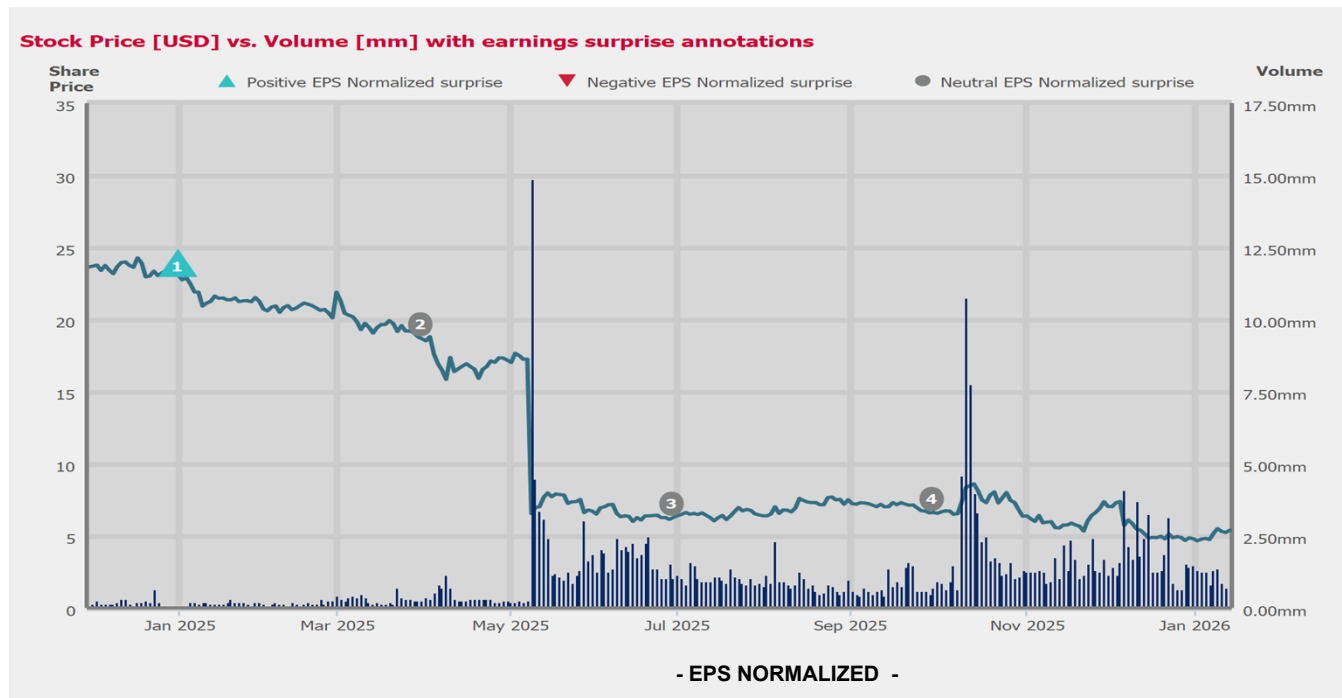
**Wednesday, January 14, 2026 10:00 PM GMT**

S&P Global Market Intelligence Estimates

	-FQ3 2025-			-FQ4 2025-	-FY 2025-	-FY 2026-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.61	(0.70)	NM	0.13	(0.70)	NA
Revenue (mm)	637.00	472.56	▼ (25.81 %)	489.40	1894.40	NA

Currency: USD

Consensus as of Jan-15-2026 11:26 AM GMT



	CONSENSUS	ACTUAL	SURPRISE
FQ4 2024	0.56	0.62	▲ 10.71 %
FQ1 2025	0.54	(0.12)	NM
FQ2 2025	0.57	(0.01)	NM
FQ3 2025	0.61	(0.70)	NM

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# Call Participants

## EXECUTIVES

**Ben Avenia-Tapper**

*Vice President of Investor Relations*

**Elias Joseph Sabo**

*CEO & Director*

**Patrick Maciariello**

**Stephen Keller**

*Executive VP & CFO*

## ANALYSTS

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**Lance William Vitanza**

*TD Cowen, Research Division*

**Lawrence Scott Solow**

*CJS Securities, Inc.*

**Matthew Butler Koranda**

*ROTH Capital Partners, LLC, Research  
Division*

**Timothy Egan D'Agostino**

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

# Presentation

## Operator

Good afternoon, and welcome to Compass Diversified's Fiscal 2025 Third Quarter Conference Call. Today's call is being recorded. [Operator Instructions] At this time, I would like to turn the call over to Ben Tapper, Vice President, Investor Relations. Ben, please go ahead.

## Ben Avenia-Tapper

*Vice President of Investor Relations*

Thank you, and welcome to Compass Diversified's Third Quarter 2025 Conference Call. Representing the company today are Elias Sabo, CODI's Chief Executive Officer; and Stephen Keller, CODI's Chief Financial Officer. We are also joined by Zach Sawtelle, Chief Operating Officer for Compass Group Management; and Pat Maciariello, who recently retired after 20 years with CGM.

Before we begin, I'd like to remind everyone that during the course of this call, CODI will make certain forward-looking statements, including discussions of forecasts and targets, future business plans, future performance of CODI and its subsidiaries and other forward-looking statements regarding CODI and its financial results. Words such as believes, expects, anticipates, plans, projects, should, and future or similar expressions are intended to identify forward-looking statements.

While these statements present our best current judgment about future results, performance and plans as of today, our actual results and operations are subject to many risks and uncertainties that could cause actual results and operations to differ materially from what we expect. 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. In addition to any risks that we highlight during this call, important factors that may affect our future results, performance and plans are described in our recent SEC filings and press release.

During the call, we will refer to certain non-GAAP financial measures. 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 CODI's press release and SEC filings. At this time, I would like to turn the call over to Elias Sabo. Elias?

## Elias Joseph Sabo

*CEO & Director*

Thank you, Ben, and good afternoon, everyone. With today's filing, we are now current with our SEC filings for 2025. We're also back in compliance with the reporting requirements under our credit facility and bond indentures, and we're returning to a more normal operating cadence. It's been a long road thus far, and I want to thank everyone for their patience throughout this process. We appreciate the support you've shown as we work through it.

Before I discuss our performance, I want to give you all a quick update on some organizational changes that have occurred at Compass Group Management, our external manager. After 20 years of dedicated service, Pat Maciariello retired at the end of 2025. Pat has been an integral member of CGM's senior leadership team, and it's been a pleasure to work alongside him over the years. Stepping into the role of COO for CGM is Zach Sawtelle. Zach has been with CGM since 2009, most recently as the leader of our East Coast office. He's been instrumental in many of CODI's most successful acquisitions in his tenure and currently chairs the Boards of BOA, PrimaLoft, Altor and Sterno.

I'm thrilled to have him take on this role, and I'm confident his leadership will support continued execution by all of our subsidiaries. Before we move on, I'll pass the call to Pat to say a few words. Pat, over to you.

## Patrick Maciariello

Thanks, Elias. It's hard to put 20 years into a few words, but I'll try. Working with the CODI team has been one of the most meaningful chapters in my life, and I want to thank each and every employee, manager and partner at Compass. I'm also grateful to the employees in each of our current and past subsidiaries. Your professionalism and hard work were evident every day. I would also like to express my gratitude to the executive teams at each subsidiary business. I have learned and continue to learn from each of you as you have modeled drive, leadership and character. Working with you has been the highlight of my career, and I will be forever grateful for the opportunity. I look forward to watching all of your continued successes from afar. Thank you.

## Elias Joseph Sabo

*CEO & Director*

Thank you, Pat. On behalf of everyone at Compass, thank you for your leadership and partnership over the years. Best of luck in your next chapter. I'll now turn to our year-to-date results and share a few operating highlights from our subsidiaries. Then I'll close with the steps we're taking to drive long-term shareholder value.

From a macroeconomic perspective, 2025 was a year marked by uncertainty driven by geopolitical risks and a fluid tariff environment. Despite that volatility, our subsidiaries, excluding Lugano, delivered mid-single-digit growth in subsidiary adjusted EBITDA through the first 3 quarters of 2025. That's consistent with the expectations we laid out at the beginning of the year. And while Lugano remains included in our reported results for the period, our focus today is on our 8 other subsidiaries. Our solid performance reflects the disciplined execution of our subsidiary management teams as well as the attractive positions our businesses hold in their respective markets. Across CODI, we own and operate high-quality, well-managed middle-market businesses that can perform through a range of economic environments.

Now let me walk through what we're seeing in each vertical and share a few examples of how our teams are driving results. Year-to-date, sales in our consumer vertical grew low single digits. BOA continues to drive significant penetration in multiple applications, including snow sports, cycling, workwear and protective headwear. The precision and performance of the BOA Fit system is unmatched. The Honey Pot is now one of the fastest-growing feminine care brands, driving continued share gains and category growth. The team has successfully launched innovative products and is taking share from legacy brands in the feminine care category. We believe this reflects the long-term appeal of better-for-you products as well as the strength of our brand, supporting strong double-digit EBITDA growth.

5.11 moved quickly to adapt to the evolving tariff environment, using supply chain actions and targeted pricing to protect performance while continuing to invest selectively to broaden the brand's reach. Year-to-date, our industrial vertical delivered mid-single-digit sales growth, supported by Altor's 2024 acquisition of Lifoam. In 2025, the rare earth magnetics market saw meaningful disruption that we believe creates a compelling long-term opportunity for Arnold. Demand for a more geopolitically secure rare earth supply chain continues to rise, while intermittent export restrictions have increased volatility. These export restrictions created short-term headwinds in 2025, but we believe they also reinforce the long-term tailwinds for the business as reflected in Arnold's growing backlog.

Today, Arnold is one of only a handful of companies producing samarium cobalt magnets in the U.S. These magnets play an essential role in the most demanding aerospace and defense applications where supply chain security and performance reliability are critical. Finally, Sterno continues to deliver double-digit EBITDA growth, driven by strength in its core foodservice offering. The Sterno management team continues to drive efficiency, including optimizing sourcing and production locations to navigate the tariff environment. These are just a handful of the accomplishments across both verticals.

Before I hand it over to Stephen, I want to reiterate our commitment to all of our stakeholders. Now that we have completed the Lugano investigation and restated our financials, we are focused on execution and on delivering consistent long-term shareholder value. While our priority remains reducing leverage to mitigate risk and ensure long-term financial flexibility, we recognize the need to drive shareholder returns, and we are taking steps to position ourselves to be able to efficiently and prudently return capital to shareholders. We believe that our current valuation represents a significant discount to the intrinsic value of our underlying businesses. If this disconnect persists, we will factor that in as we consider the greatest risk-adjusted return opportunities, including the efficient return of capital.

The bottom line is that we are committed to a better outcome for all of our stakeholders. With that, I'll now turn it over to Stephen.

**Stephen Keller**  
*Executive VP & CFO*

Thanks, Elias. As a reminder, our reported results still include Lugano Holdings, unless otherwise stated. Lugano will be included in our consolidated results through November 16, 2025, the date that entered Chapter 11 bankruptcy proceedings and will be deconsolidated thereafter. For the third quarter, net sales were \$472.6 million, up 3.5% year-over-year. GAAP net loss for the quarter was \$87.2 million, which includes expenses related to the Lugano investigation as well as Lugano's operations.

Now given the timing of this call and because this is the first time we publicly discussed our 2025 results, I'll focus my commentary on year-to-date performance. This captures the first 3 quarters in full and helps normalize for inter-quarter shifts as customers prepare for and then reacted to changes in the tariff landscape. Year-to-date, consolidated net sales were \$1.4 billion, an increase of 8.6% over the prior year or 6.1%, excluding the impact of Lugano. In our consumer vertical, sales were up 3.1%, driven by very strong growth at the Honey Pot with additional contribution from 5.11.

Year-to-date, BOA declined slightly as the team exited a lower value, less performance-oriented business in the children's market in China. This planned exit supports BOA's long-term strategy. Excluding the children's business in China, BOA's core business grew double digits. Year-to-date, sales in our industrial vertical grew 10.5%, driven primarily by Altor's acquisition of Lifoam. Growth was partially offset by near-term headwinds at Arnold due to the geopolitical uncertainty and disruptions in the rare earth supply chain. As discussed, while that disruption creates short-term challenges, we believe it also reinforces the long-term strategic relevance and growth opportunities of that business.

Excluding Lugano, year-to-date subsidiary adjusted EBITDA was \$257 million, an increase of 5.8% over 2024. The growth in subsidiary adjusted EBITDA was primarily driven by double-digit growth at the Honey Pot and Sterno as well as Altor's acquisition of Lifoam. This growth was partially offset by short-term challenges at Arnold as it deals with the rare earth supply chain disruptions and broader tariff-related uncertainty. Our consolidated net loss year-to-date was \$215 million, which includes \$155 million loss at Lugano.

Public company costs and corporate management fees were \$99.5 million year-to-date. Included in that amount is more than \$37 million of onetime costs associated with the Lugano investigation and restatement. CODI and our Board continue to work with the manager to fully recoup overpaid cash management fees from prior periods affected by Lugano's results as originally reported. The overpayment of which will be partially offset by a voluntary cash management fee reduction made by the manager during 2025.

In the fourth quarter, we expect to reconcile these items through a significant true-up related to the restatement. We expect this to result in a onetime noncash benefit in CODI's P&L and the recognition of a current asset that will be used to offset future cash management fees. CODI expects to fully recoup the overpaid cash management fees by the end of 2026.

Turning to our cash flow. Year-to-date, we used \$54 million of cash in operating activities, primarily due to costs associated with Lugano's operations and its disposition. Year-to-date, we have invested \$34 million in capital expenditures in line with the prior year as we continue to protect and invest in our 8 subsidiaries to support sustained growth. We ended the third quarter with \$61.1 million in cash and cash equivalents and less than \$10 million used on our revolver. As a reminder, due to the credit agreement amendment we signed in late 2025, we have restored access to the full \$100 million capacity on our revolver.

As Elias discussed, reducing leverage is our priority, and we are focused on deleveraging both organically and through value-accretive strategic transactions, including the potential opportunistic sale of one or more businesses. The credit agreement amendment we signed in December gives us the time and flexibility to deleverage in an orderly way. Under the amended agreement, our leverage covenant is relaxed through 2027 with milestone fees paid to the lender beginning June 30, 2026, if our leverage ratio is not below 4.5x, which serves as an incentive for faster deleveraging. That structure allows us to deleverage organically while remaining in compliance. It also preserves the flexibility to accelerate deleveraging through a value-accretive sale of one or more business. As a reminder, our year-end leverage ratio, excluding the deconsolidated Lugano results, is expected to be around 5.3x.

Finally, we expect to continue to fund the growth of our subsidiaries alongside our debt reduction and to maintain appropriate liquidity as we execute against our plans.

Turning to our outlook for 2025. Consistent with previously communicated guidance, we are tightening our expected subsidiary adjusted EBITDA range, excluding Lugano, to between \$335 million and \$355 million. We'll provide an outlook for 2026 when we hold our fourth quarter call. However, we do expect to organically deleverage in 2026 through solid growth in our subsidiary adjusted EBITDA. As has been our practice, our outlook does not include the impact of any potential acquisitions or divestitures and assumes no incremental material impact from changes in the tariff environment or other macro and geopolitical developments.

Finally, we know many investors have inquired why members of management and the Board have not yet purchased shares following the completion of the restatement. The main reason is timing and process. Given the cadence of our SEC filings this year, we expect our insider trading window to remain closed until after we file our 2025 Form 10-K and complete the annual audit. When the window does reopen, any purchases would be subject to our normal preclearance and compliance procedures. With that, I'll hand it back to Elias for closing remarks.

**Elias Joseph Sabo**  
*CEO & Director*

Thanks, Stephen. Before I wrap up, I want to share one additional thank you from our Board and everyone at CODI. James Bottiglieri retired from the CODI Board at the end of last year. For over 20 years, Jim was a key member of both the management team and eventually our Board. Jim was instrumental in our initial public offering and has been a valued Board member, providing deep institutional knowledge, financial expertise and wise counsel to the Board and management. We truly appreciate everything he contributed to CODI.

Now as I conclude today's prepared remarks and we look ahead, I want to reiterate our commitment to generating sustained long-term shareholder value. This objective is reflected in our capital allocation priorities to reduce leverage, invest for growth and long-term value creation and at the appropriate time, return capital to shareholders. With 2025 in the rearview mirror, we're ready to get back to what has historically defined CODI. We believe we have a battle-tested business model, strong enough to withstand the unprecedented events of this past year. We offer a permanent capital approach that allows us to acquire, manage and grow attractive businesses that are leaders in their space. We provide shareholders access to high-quality middle-market businesses backed by engaged ownership, strategic resources and a long-term approach, while empowering strong management teams to run and grow our subsidiary businesses. We know 2025 was challenging, and trust is earned through consistent execution. That's our focus as we enter 2026. With that, Stephen and I will now take your questions. Operator, please open the lines.

# Question and Answer

## Operator

[Operator Instructions] And our first question comes from Lance Vitanza with TD Cowen.

**Lance William Vitanza**  
*TD Cowen, Research Division*

Congratulations on getting the restatement done. My question would be with respect to the Honey Pot. My recent channel checks seem to suggest both more shelf space and also faster inventory turns than at least I had expected. And I'm wondering if you could comment on how the performance has been shaping up relative to your internal expectations? And to the extent there's been outperformance on that basis, what do you think the drivers of that have been?

**Elias Joseph Sabo**  
*CEO & Director*

Sure. And thank you, Lance. First feels good to be back up to date with all of our filings and the company getting back to a more normal operating level. With respect to the Honey Pot, this is really an extraordinary brand. I think we told you when we bought this business that this was a company that was founded by an extraordinary woman and that she was really changing kind of the entire industry and using better-for-you products. And it was mostly a business that was in the kind of more of the hygiene side, and it was not in the broader part of the feminine hygiene market. It was in more of the washes and wipes. And so that's a very small market.

One of the things that the company has been able to do, and it was always part of the plan was to extend the brand into other categories. And in this case, the company has been able to get into the menstrual category, which is a massive market compared to the market they were entered into before. And we've had very successful execution. Our product really does stand for something in our brand and with our customers, it's extendable into other adjacent categories. And so what we've seen is more shelf space being dedicated to us in this new category, and our turns are doing really extraordinarily well. So relative to expectations, I can tell you the company is significantly outperforming expectations given kind of the additional shelf space that we continue to talk to our retailers about as the next year gets set, we expect that growth to continue. And we're investing in the brand. You just see a lot more marketing. It was always our strategy. And so everything is coming together, and it is really producing wonderful results. And I think '26 is shaping up to be a great year.

**Lance William Vitanza**  
*TD Cowen, Research Division*

That's really helpful. I appreciate it. If I could just squeeze in one last question. On the divestiture front, and I know you've talked about this previously, but could you just sort of remind me like are there any assets that are off the table there that you would just simply not consider selling at any price? Or should we just consider this you're going to look to maximize shareholder value. And if that's subsidiary, XYZ, it's subsidiary XYZ?

**Elias Joseph Sabo**  
*CEO & Director*

Yes. I would say everything -- our model has always been everything is for sale at all times. It all comes down to the value that you're willing to pay. And to the extent that's attractive to us, we would always be a seller under those circumstances. Nothing has changed with respect to that, Lance. So absolutely, all of our businesses remain available for sale because that's the basic kind of business model that we have. Now I would tell you that some of our companies that are growing really fast and have great dominant market positions. And I think we all know kind of some of those businesses that we have. Look, the valuation expectations are going to be really high. And if they fail to materialize, we are in a position where although we would like to divest the business, we don't have to and what we won't do is take a big discount on a premium asset.

And so I would just say, yes, everything remains available for sale. That's always been the case. We do have a firm-wide desire to be in divestment mode in order to shrink our balance sheet to get back to normal leverage and then have capital allocation available to us again. Stephen mentioned, part of that is clearly looks at buying back stock as a capital allocation opportunity. And at these prices, we would think that's pretty attractive. So divestment is what we would like to achieve, but it is not without kind of respect to valuation, and we'll be very disciplined in executing that.

## Operator

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Our next question comes from Larry Solow with CJS Securities.

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

Great. Welcome back, I guess, to the current financial world. Also just want to extend my best wishes to both Pat and Jim, great working and personal relationships with both of them. So I wish you guys both best of luck. I guess first question lies is just kind of just broad brush. I know you called out good color on all your holdings, quite frankly. But growth seems like it slowed a little bit. I think you grew kind of 8% first quarter and 2% or 3% this quarter. It looks like it's probably more just timing in some of your bigger holdings like BOA. I think maybe timing there and also the Chinese exit. So -- but just from a broad brush, how do you see the economy like today versus -- I know you had a lot of other things on your mind, but maybe at the start of the year and just...

**Elias Joseph Sabo**  
*CEO & Director*

Yes. Thank you, Larry. Thank you for the warm wishes for Pat and Jim. They have both been really valuable participants here in building Compass and have become friends with us all, and we wish them the best in their future endeavors. With respect to the economy and kind of how we see things or saw things unfold, yes, we did have a really strong Q1 and things moderated in Q2 and Q3. We saw a little bit of a pull forward of some demand that we think otherwise would have materialized on a more normalized pattern with the kind of Liberation Day announcement and there was a period of time where you could still bring some goods in, and I think everybody kind of rushed to do that.

So there's a bit of distortion, I would say, quarter-to-quarter because of that. But look, if we're going to normalize for that, there still is a bit of a slowdown that occurred after Liberation Day. And as you'd anticipate, there's -- look, a lot of inflation. There was some inflation that came through still, and it was very disruptive for a lot of companies. And I think consumers just got to the point where they weren't willing to take any additional inflationary pressures. So that's been a very difficult environment in which to operate. I would say 5.11 has probably had the biggest impact from that because we produce in Southeast Asian countries, not China. We were, I think, quick enough to get out of China when the President was in his first term and there was a lot of rumblings.

But in adjacent markets where you produce a lot of apparel, there's still 20% tariffs and you have a customer set that is very reticent to take any incremental price increases, that's a tricky spot that companies, I think, across a lot of different industries are finding themselves in. So it may not impact directly a BOA or PrimaLoft. But if our customers are feeling those same headwinds, then that impacts us. And so I'd say broadly, Larry, these tariffs have kind of slowed down at least the consumer side of the business. The industrial side of the business clearly had a very unique kind of impact from the export restrictions that China put on rare earth minerals.

As a result of that, there's -- as you see in Arnold's results, millions of dollars of EBITDA reduction that occurred. I think that is a little bit more kind of one-off, and we expect that to revert back to normal in 2026. And so that had some impact on kind of the weaker results in the back half of the year. But I would just say broadly, things slowed a little bit, but still feel like they're growing.

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

Yes. And I know, listen, you're not giving guidance for next year yet, but you have spoken about sort of getting your leverage down organically into the mid-4s. So that would imply some growth. And it does feel like you're -- even if consumer slows a little more, you'll -- Altor sounds like it's going to -- I know it's basically flat this year, maybe organically, but it seems like that's not really -- a lot of that's noneconomically related with the cold storage. And as you mentioned, Arnold should bounce back a little bit, right, next year, hopefully. So it feels like your outlook, you're kind of holding into that outlook, continue to at least grow somewhat next year without getting ahead of our skis.

**Elias Joseph Sabo**  
*CEO & Director*

Yes. We're going to give an outlook for next year here, I guess, sooner rather than later because we're going to have our year-end call more quickly than normal. But I would say, Larry, we have very strong expectations that we will have a growth year next year and that our free cash flow is going to be very strong. And heretofore, we have not produced actual free cash flow because it's been invested in growth in working capital and other assets.

In 2026, when you talk about deleveraging path, there's 2 forms that it comes in. One is we expect growth of the portfolio. And number two, we expect to grow and have actual free cash flow that repays indebtedness and has a lower gross amount of debt at the

end of the year. So when you -- so that is going to be something, and we're not giving guidance today, but I would tell you, when we do give it in 5, 6 weeks or whatever the timing is, it's going to include that kind of like foundational tenets.

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

Awesome. That sounds great. If I could just one more housekeeping question. Stephen, just on -- can you give us a sense of sort of like a normalized management fee today. I guess it sounds like there'll be some noncash accounting true-up in Q4 that will kind of roll through the P&L next year. But -- so maybe as we enter '27, obviously, your company may look a whole lot different. But based on what the current holdings and net asset value is, like can you give us an idea what that normalized number would -- and then...

**Stephen Keller**  
*Executive VP & CFO*

Yes. I think it's -- so look, obviously, we need to do a little bit of work to true up all the kind of overpaid management fees. And like as you mentioned, there will be some adjustments in Q4. But from a management fee cost perspective, noncash, I would say, for next year, I think it's probably -- you can probably assume it's in the -- it's around \$55 million, including what's paid directly by the subsidiaries. That's probably a good number based on our current portfolio of businesses and excluding any impact from Lugano -- excluding any fees, obviously, Lugano will be deconsolidated and those assets won't be under management.

From a cash perspective, next year, it will be substantially less as basically CODI will have lower cash payments to CGM to make up for the overpaid management fees that have been paid historically. So cash will be a lot less. But from an accounting perspective, you can assume around \$55 million.

**Operator**

Our next question comes from Timothy D'Agostino with B. Riley Securities.

**Timothy Egan D'Agostino**  
*B. Riley Securities, Inc., Research Division*

Congrats on being current in everything, really big accomplishment. I guess my first question kind of goes back to asset sales. It would be great to get some color on who might be interested or how you might go about a sale, not necessarily what you're selling. The reason why I ask is I think back to Fox Factory, and I wonder if there's any potential of like maybe like bringing a company public and that being a way of sale -- way to sell an asset. So I guess my question is, what are the different avenues you can explore when going to sell one of these assets?

**Elias Joseph Sabo**  
*CEO & Director*

Yes. Tim, thank you for the question. This is Elias. In selling an asset, I mean, I think there are a number of avenues. Fox was an example of an IPO. If you remember not too long ago, we filed actually right before the market kind of took a turn for the worst in 2022, an IPO for 5.11. And we withdrew that just because of market conditions, but that's a company that is kind of a size that potentially could explore that kind of pathway. And in fact, other companies are at that size or getting to that size as well.

So IPO becomes an absolute route for which we can monetize the position. I think that route has the benefit of unlocking value and demonstrating that to the market, but it does not have the benefit of quick deleveraging because inevitably, we become a large holder of those shares, and we have to, over a series of years, make orderly sales to be able to monetize that. So although I think that is a great way for us to monetize assets, and we have that in our portfolio of things we would do, I would say it comes at the cost of not having quick liquidity.

For faster liquidity, I'd say the routes are through investment banks typically that we engage and they go out and talk with kind of strategic buyers, private equity buyers. Tim, understand because we're in the market all the time and we're engaging in the market, we're getting inbounds and we are talking with bankers constantly about strategics or other PE firms that may have interest in our assets and then conversely assets that we may have interest in. Now '25, we weren't doing really the latter, looking for assets clearly. But there's always kind of that chatter that is going on.

So I think just in the normal operations, we have a pretty good understanding of where strategics are right now by our different companies and their acquisition cycles. who's expressed interest, who has not, where PE firms are in that process. And what we try to do is get a sense of what is the demand for an asset like this, typically using investment banking partners to help us do that. And the ones that we feel we can get the greatest amount of interest and demand for are assets that we're kind of bringing out to market.

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Now I will say, and we've said this before, we have a couple of assets, a few that we are looking at this. We don't -- we're not saying we're going to sell multiple assets this year, but we do want to execute against a sale, and we don't want to give leverage to any potential buyer. And so in that process, we'll look at a few different businesses that we feel there's sufficient demand in the marketplace to warrant a good value and then we'll determine which one that we will want to divest based on how the market materializes.

**Timothy Egan D'Agostino**

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

Okay. Great. That's super helpful color. And then if I can just ask another. Going forward in '26, the way you oversee the portfolio companies, has your oversight changed for how you go about it? If you could just provide any color there.

**Stephen Keller**

*Executive VP & CFO*

Yes. So I think what we talked about on the restatement call is that from an internal audit perspective and a compliance perspective, we have made some changes. We did decide to outsource our internal audit function with the idea that using a third party would allow us to do 2 things. One, it allows us to easily scale up and down the size of the team based on the assets that we have and the companies that we're running. And then the second thing is also when you use an outsourced team, when you get businesses that are -- have unique characteristics, it's easy for you to get industry-specific experience and quickly flex it up and down.

And so we think the changes in internal audit and compliance moving to an outsourced model will be a better model. That's the primary change that we are making in terms of the oversight. There's also some other internal processes that we'll be looking at. But we do want to recognize, the situation with Lugano was very, very terrible. It was unprecedented. It was also very unique and very unique to that situation. So as we talked about on the other call, we have -- we'll probably change a little bit of some of our criteria where we would not necessarily want to have a someone who is a founder, still CEO, still owns 40% and a key man, that's probably a risk that we, in retrospect, would like to structure differently if we had another deal.

So we will make some changes like that. But overall, we got to remember that the situation at Lugano was very, very isolated to Lugano. And so generally speaking, the model that we have had and the oversight we've had of these companies have worked very, very well for 20 years. And this is a very unique situation driven by a very unique individual.

**Operator**

Our next question comes from Matt Koranda with ROTH Capital.

**Matthew Butler Koranda**

*ROTH Capital Partners, LLC, Research Division*

Best wishes to Pat, you'll be missed. I guess what I wanted to make sure I understood, it sounds like we're motivated to sell an asset at some point this year, but we don't feel a whole lot of pressure given you have multiple good assets that you could potentially sell. The 4.5 leverage covenant that you have by midyear, is that something you could actually attain organically even just given the cash unlock from working capital that you could get this year?

**Stephen Keller**

*Executive VP & CFO*

So first of all, it's not a -- there's an incentive to get below 4.5. If we're not below 4.5, there's a payment. We won't be out of covenant. The covenant is actually higher. So we will be in covenant -- we are now and we will continue to be all next year. There is a -- look, with some recovery from Lugano, assuming that we have, there would be a path to getting below 4.5% organically, but it would be tighter than we would like, which is one of the reasons why we're trying to operate in a sense that we will be able to organically delever and therefore, that allows us to -- any asset sales to accelerate it and gives us more comfort.

So we'll go down both paths. We're not going to sell -- we do not want to sell a business at a discount that will destroy shareholder value. So we're focused on being able to get below if we -- if a sale at the right valuation doesn't materialize. We do, however, expect to sell a business.

**Matthew Butler Koranda**

*ROTH Capital Partners, LLC, Research Division*

Okay. All right. That's fair. That helps. And then I just wanted to hear a little bit more about Arnold and supply chain disruption, how long that sort of should be playing out or if it's already essentially solved in your mind and that just is going to take a little time to percolate through the business. Just an update there.

**Elias Joseph Sabo**  
*CEO & Director*

Sure. So as we all know, the trade liberation day and the tariffs on China caused a lot of global issues and retaliation by China in certain areas. Matt, the area where China has the most leverage is over rare earths, currently, something like 90% of all Neo magnets are produced in China, and I think something like 70% of all samarium cobalt, which is what we produce is produced in China. So they're just a massive player. They obviously have a lot of the raw material that's there. And these are absolutely integral as we think about the AI economy, alternate energy kind of production to serve the AI economy partly. And then robotics and electric cars, all of these things require rare earth magnets.

And so the future growth of economies is dependent on this. Clearly, China flexed their muscle and put export controls that we were not able to comply with. No company would have been able to comply with them. And as a result, that shut down pretty much all the business that we had that we could export out of China. That's kind of a \$6 million to \$8 million EBITDA disruption that we got hit with there. Now what's happened is China has loosened export controls and we're seeing products start to flow back out of China. But the longer term, so we expect normalization, and that's already happening in the fourth quarter. And we have a backlog that we need to obviously catch up. So that provides a good tailwind going into 2026.

Now the global landscape has really shifted because these are -- we work mostly with aerospace and defense customers. That's where samarium cobalt, magnets kind of really shine. And so that part of the market is very sensitive to just-in-time inventory ordering, and we deal with customers that are very -- the economy is dependent on them. Our national security is dependent on these customers. And so the stakes are very high. Clearly, our customers were rattled when we were not able to deliver product on schedule because of these export restrictions. And it wasn't just us, it was everybody they were buying from in China.

And so what we've seen, and this is where we believe there's a lot of bullishness around Arnold, and we think the upside trajectory for this company over the next few years is well above trend. There is a desire for a lot of our global customers to source their material in a more stable geography. And they're looking for U.S. or European or other Southeastern Asian country like Indonesia has got a Neo mine that's coming on. There is a big effort to diversify the supply base out of Mainland China, which is where it exists today. As we said in our prerecorded script, there's only a handful of us that can do that.

And so we sit in a pretty good position to be able to secure a lot of additional business and drive our business growth much faster than it otherwise would be. And that's why notwithstanding the short-term pain we suffered in 2025, I think in terms of underlying enterprise value of the Arnold business, this was a massive positive to that, and we expect it to manifest in future growth rate of earnings.

**Operator**

[Operator Instructions] And I'm not showing any further questions. I would now like to turn the call back over to Elias Sabo for any closing remarks. We do have one question...

**Elias Joseph Sabo**  
*CEO & Director*

Thank you all for -- sorry.

**Operator**

Our next question comes from Cris Kennedy with William Blair.

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

Congrats on Pat's retirement. Just wanted to follow up on the last comment you made about Arnold. I mean it was almost a year ago when you had the Investor Day and you kind of gave long-term organic revenue growth targets for each of the subsidiaries. Any updated thoughts on that framework that you provided previously?

**Elias Joseph Sabo**  
*CEO & Director*

Yes. I would say, obviously, clearly, Cris, we were wrong with Arnold in 2025. And so let's assume that we kind of get back to a normal baseline, which '24 would serve as a normal baseline year. I think we would expect those growth rates temporarily because I don't know if this is a long-term shift. That actually looks into use of robotics and other things that may have longer-term demand generation that is outside of what we are seeing today. In the short term, though, let's say, 3 to 5 years, we would expect a materially higher growth rate from Arnold given the supply chain disruptions that we talked about and the resourcing of production.

**Cristopher David Kennedy**

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

Okay. And how about the other subsidiaries now that you have more working capital to allocate potentially that Lugano has gone?

**Elias Joseph Sabo**

*CEO & Director*

Yes. No, we'll obviously talk more about that on our Q4 call and about our 2026 guidance. But I would say largely, our companies outside of Lugano are performing with the exception of Arnold that we mentioned are performing in line with expectation. Where we've noted we find things that are doing a little bit better is the Honey Pot. And I would say 5.11 is struggling a little bit because of tariffs. But largely, BOA, PrimaLoft, the other businesses, Sterno, they're performing in line with where our expectations are. And I'm not sure if you just went 1 year hence from last year's Investor Day, there'd be a lot of change. It probably would be more maybe 5.11's growth rate is a tad lower and Honey Pot is a tad higher.

**Cristopher David Kennedy**

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

Got it. Okay. And then I understand you're not going to give commentary in 2026. But can you just remind us of kind of what the free cash flow conversion is of the business or how we should think about that?

**Stephen Keller**

*Executive VP & CFO*

Yes. Thanks. It's a great question. I think it's really important to think about because 2 things have really changed since last year, which is one is Lugano no longer be in the portfolio, which is a significant user of working capital. Our underlying businesses now generate a substantial more amount of cash. That, coupled with the elimination of the common dividend suggests that we will, from a free cash flow perspective, be creating pretty significant free cash flow. We actually expect -- depending on working capital usage and the timing, we'd expect that in 2026, that we should generate between \$50 million to \$100 million of free cash flow after everything, after interest, after dividend, after preferred dividends and all capital CapEx, et cetera.

So that is a marked change from, I would say, where we have been historically. And so that is something that we're -- that's one of the reasons why we're very confident in the fact that we will be able to organically delever on top of looking at these more strategic, more rapid delevering activities.

**Operator**

I would now like to turn the call back over to Elias Sabo for any closing remarks.

**Elias Joseph Sabo**

*CEO & Director*

Thank you, everyone, for joining our call today. We understand this has been a very difficult last almost year for all of us. We are really excited to be caught up, and we look forward to speaking with you all again in another couple of months and previewing our 2026 expectations. Thank you, and have a great day.

**Operator**

Thank you. This concludes the conference. Thank you for your participation. You may now disconnect.

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