Latham Group, Inc.

Third Quarter 2024 Earnings Conference Call

Tuesday, November 05, 2024, 4:30 PM Eastern

CORPORATE PARTICIPANTS

Scott Rajeski - *President and Chief Executive Officer*

Oliver Gloe - *Chief Financial Officer*

Casey Kotary - *Investor Relations Representative*

PRESENTATION

Operator
Good afternoon, and welcome to the Latham Group Third Quarter 2024 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing "*" then "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your telephone keypad, to withdraw your question, please press "*" then "2." Please note this event is being recorded.

I would now like to turn the conference over to Casey Kotary, Investor Relations Representative. Please go ahead.

Casey Kotary
Thank you. This afternoon, we issued our third quarter 2024 earnings press release, which is available on the Investor Relations portion of our website, where you can also find the slide presentation that accompanies our prepared remarks.

On today's call are Latham's President and CEO, Scott Rajeski and CFO, Oliver Gloe. Following their remarks, we will open the call to questions.

During this call, the Company may make certain statements that constitute forward-looking statements which reflect the Company's views with respect to future events and financial performance as of today or the date specified. Actual events and results may differ materially from those contemplated by such forward-looking statements due to risks and other factors that are set forth in the company's annual report on Form 10-K and subsequent reports filed or furnished with the SEC as well as today's earnings release. The Company expressly disclaims any obligation to update any forward-looking statements, except as required by applicable law.

In addition, during today's call, the company will discuss certain non-GAAP financial measures. Reconciliations of the directly comparable GAAP measures to these non-GAAP measures can be found in the slide presentation that accompanies our prepared remarks, which can be found on our Investor Relations website.

I'll now turn the call over to Scott Rajeski.

Scott Rajeski
Thanks, Casey and thank you all for participating in today's call to discuss our third quarter results and review our business outlook. Our third quarter performance was mostly consistent with our expectations and again demonstrated both Latham's resilience and progress within a challenging industry environment. In terms of this quarter's key takeaways, first, market conditions through quarter-end played out in line with our initial expectations for an approximate 15% decline in new pool starts this year.

Second, with this as a backdrop, we continue to drive awareness and adoption of fiberglass pools and automatic safety covers, two key growth areas for Latham. Third, our lean manufacturing and value engineering programs, together with improved procurement activities resulted in meaningful cost reductions that led to stable gross profit and expanded gross margin in the third quarter on lower year-on-year sales.

And lastly, we ended the third quarter in a strong financial position with cash of approximately $60 million after having disbursed approximately $65 million for the Coverstar Central acquisition and repaid approximately $20 million in debt in the first nine months of this year.

Latham's growth strategies and leadership position in fiberglass pools are enabling us to outperform this industry downturn and are positioning us as a prime beneficiary of a market recovery. We have the broadest lineup of pool configurations, the widest range of price points and the greatest array of specialty features including spas and tanning ledges. Also, with 12 fiberglass manufacturing facilities globally, we are best positioned to serve the major US markets and Canada.

In the third quarter, Latham's fiberglass pool sales have continued to show relative strength. Their market differentiators are compelling; cost efficient, fast and easy to install, and requiring fewer chemicals to maintain. And our commitment to innovation to address and anticipate consumer preferences is another element driving increased adoption of fiberglass pools. For example, we added to our plunge pool offering earlier this year with the launch of the Enchantment series in several markets with a plan to expand to all of the US in 2025.

While plunge pools represent only a small percentage of our total in-ground pool sales, they are a growing category for us as they appeal to consumers looking for space saving, affordable options for aquatic exercises, rehabilitation, and recreation. These attributes are particularly attractive in the Sand States where we are deploying more resources to gain share for fiberglass in the coming years. Based on our year-to-date results, we expect fiberglass pools to account for about 75% of our total in-ground pool sales in 2024, in line with our original projection.

We also significantly strengthened our position in automatic safety covers in the third quarter with the August 2nd acquisition of Coverstar Central. The key integration activities are complete and revenue synergy initiatives are underway. We are entering the 2025 season with an integrated marketing and sales strategy aimed at accelerating the growth of this standout product line.

Latham's automatic safety covers provide unparalleled safety and other significant operating cost savings, including reductions in heating and electricity costs and water and chemical usage for the homeowner. As a reminder, these covers can be fitted to all pool types, and we see opportunities to leverage Coverstar Central's long-standing relationships with pool builders in its markets to increase their awareness of the fiberglass pool value proposition.

As Oliver will detail in a moment, we were pleased to be able to maintain third quarter gross profit levels that were stable with the comparable period last year and expand gross margin by 250 basis points despite lower sales. These results reflect the substantial benefits that Latham has gained from actions over the last two years to reduce costs and drive production efficiencies. Year-to-date, we are tracking nearly $8 million in savings from our lean manufacturing and value engineering initiatives with the largest portion coming from our fiberglass plants.

Additionally, our focus on safety has yielded a significant drop in incidents across all manufacturing locations. We believe that Latham's operational and financial model has structurally changed, which has increased our underlying earnings capabilities amid an industry recovery and will enable longer-term margin expansion. And we are increasing our investments in sales and marketing and product development initiatives to ensure that we capture an incremental share of in-ground pool sales once volumes rebound.

The organic growth strategies we are executing are centered around driving adoption of fiberglass pools and automatic safety covers. Additionally, we are focused on continuing to gain share in the Sand States where we are underrepresented.

We are evolving our mix of pool styles to offer more rectangular and plunge pools and more pool-spa combos with a laser focus on master planned communities in our target markets where we already have seen strong lead generation and the continued conversion of top builders, who recognize the benefits of the industry-leading lead times and ease of installation associated with Latham's fiberglass pools.

We plan to execute on our goal of increasing the adoption of automatic safety covers in tandem with our plans for fiberglass pool market share gains as well as through channeling the combined resources of Latham and Coverstar Central to effectively reach the builder and consumer markets.

Importantly, all the capabilities to achieve our growth objectives are already resident at Latham. We now have an impressive team in place that is dedicated to driving our growth in the Sand States and we are confident in their abilities. Additionally, we have the financial flexibility to consider strategic acquisition opportunities like Coverstar Central that are accretive and provide us entry into new markets, strengthen our position in existing geographies or enable us to accelerate growth of existing product lines.

Lastly, we are pleased to report that none of our employees in areas impacted by the recent hurricanes were physically hurt and our Zephyrhills plant did not suffer damage beyond several fallen trees. However, the plant was shut down for about a week due to power loss and limited site access and customers in Florida, Georgia, and the Carolinas pushed out some orders. Given this, along with our visibility through year-end now that much of the pool building season is behind us, we have narrowed our guidance ranges for net sales and adjusted EBITDA.

Now, I would like to turn over the call to our CFO, Oliver Gloe, for a financial review. Oliver…

Oliver Gloe
Thank you, Scott and good afternoon, everyone. Please note that all comparisons that I will discuss today on a year-over-year basis compared to the third quarter and first nine months of fiscal 2023, unless otherwise noted.

Net sales for the third quarter were $150.5 million compared to $160.8 million in the prior year, down $10.3 million or 6.4%. This decrease is primarily due to lower sales volumes, which is consistent with our expectations for a 15% decline in new pool starts in 2024 with the year-to-date outperformance driven by our leadership in the faster growing fiberglass pool and auto-cover markets.

Across our product categories, in-ground pool sales declined 9.8% in the third quarter, liners declined 8.1%, and covers were approximately in line with the prior year aided by the acquisition of Coverstar Central. Gross margin expanded by 250 basis points to 32.4% in the third quarter even in light of lower utilization rates reflecting the continued success of our lean manufacturing and value engineering initiatives as well as procurement improvements driving production efficiencies that resulted in lower material costs. As expected, gross margin also benefited from the accretive impact of our acquisition of Coverstar Central.

SG&A expenses increased to $28.3 million, up $4.9 million, primarily due to an increase in spending on sales and marketing initiatives as we continued to invest in future growth and position ourselves for a rebound in new pool starts. It also reflects an increase in performance-based compensation expense as well as the addition of Coverstar Central's SG&A expenses.

Net income was $5.9 million or $0.05 per diluted share, compared to $6.2 million or $0.05 per diluted share for the prior year's third quarter. Adjusted EBITDA was $29.8 million, a decrease of $6.3 million or 17.3% from last year's $36.1 million and our adjusted EBITDA margin was 19.8%, a $260 basis point decline from 22.4% in the prior year period.

Now turning to our year-to-date results comparison, net sales were $421.2 million compared to $475.6 million. Net income was $11.3 million versus a loss of $2.5 million. Adjusted EBITDA was $76.6 million, approximately in line with $78.1 million in the prior year. Adjusted EBITDA margin increased 180 basis points to 18.2% from 16.4%.

Turning to our balance sheet and cash flow statement, we continue to maintain a strong financial position with cash of $59.9 million at the end of the quarter after the purchase of Coverstar Central for approximately $65 million in August and the repayment of approximately $20 million of debt year-to-date. We continued to effectively execute on cash flow generation with net cash provided by operating activities of $37.2 million in the third quarter and $55.2 million for the first nine months. This includes over $22 million of inventory reduction year-to-date.

Total debt as of the end of the period was $282.8 million with a net debt leverage ratio of 2.6, up from the prior quarter primarily due to the acquisition of Coverstar Central. On a pro forma basis, our net debt leverage ratio was 2.4 at the end of the quarter.

Our capital expenditures were $4 million for the third quarter and $13.9 million for the first nine months of 2024. CAPEX continues to be in line with our guidance of approximately $5 million per quarter and our CAPEX expectations for the remainder of the year remain unchanged.

Turning to our acquisition of Coverstar Central in August, the integration continues to progress as expected, with key integration activities completed and revenue synergy initiatives in progress. Financial performance for the third quarter and our expectations through year-end are in line with our prior guidance. We expect Coverstar Central to add $20 million of net sales and expand our total company adjusted EBITDA margin by approximately 140 basis points on an annual basis.

We continue to expect an approximate 15% decline in new pool starts for 2024, with the bulk of the pool building season now concluded. Based on our current visibility through the end of the year, we have narrowed our guidance ranges for net sales and adjusted EBITDA. Our net sales guidance range for 2024 is now $500 million to $510 million, which, as Scott explained, relates to the anticipated impact from the recent hurricanes and our visibility through the end of the year.

We are also narrowing our adjusted EBITDA guidance to a range of $77 million to $83 million and reaffirming our midpoint of $80 million. Our CAPEX guidance remains the same at $18 million to $22 million. As we have previously noted, our guidance for the remainder of 2024 reflects the normal seasonal slowdown in the back half of the year and we'd like to reiterate that year-over-year comparisons for adjusted EBITDA are more difficult now versus the first half of 2024.

This is due to two factors. First, the second half of 2023 benefited from the positive impacts of our previously announced restructuring projects and second, in 2024 we've increased our investments in our sales and marketing initiatives to position Latham for accelerated growth when the market recovers.

With that, I will turn the call back to Scott for his closing remarks.

Scott Rajeski
Thank you, Oliver. The long-term growth opportunities for Latham are substantial. As the largest in-ground pool manufacturer in North America and the market leader across our product portfolio, we are positioned to benefit from the strength of the outdoor living category as consumer confidence builds and financing pool ownership becomes more affordable. In the meantime, we continue to invest in growth initiatives while driving operating efficiencies throughout the organization.

To wrap up, I would like to thank our employees, partners and customers for enabling Latham to continue to outperform the industry and retain our recognition for quality products and superior service levels.

Operator, I would like to open the call to questions.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press "*" then "1" on your telephone keypad. If you are using a speakerphone, we ask you to please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2." We'll pause for just a moment while we assemble our roster.

And our first question today comes from Ryan Merkel with William Blair. Please go ahead.

Ryan Merkel
Hey, good afternoon. Thanks for taking the questions.

Scott Rajeski
Hey, good afternoon, Ryan.

Ryan Merkel
So first off, great job on margins. And, Scott, you said something I want to dig into a little bit. You said that you think you can significantly increase profitability, you structurally changed the business for higher margins, can you just unpack that a little bit more? And can we get back to 20%-plus EBITDA margins in a recovery scenario?

Scott Rajeski
Yes. So, Ryan, I'll give you a kind of high level and let Oliver kind of break it down a little bit. But let's just go back and revisit 2Q this year, go back to 3Q last year where we were over 20% EBITDA margins in both of those quarters. If you go back and revisit the restructuring initiatives we had in 2023 that carried over into early 2024, which included closing several facilities, you take that, you combine that with all of our value engineering, the lean events, the cost reduction initiatives we've been driving, trying to get to an ongoing underlying 3% roughly of, think of cost reduction initiatives on a material basis going forward, I think all of that helps.

Plus, we've invested in the business to be much bigger scale than we have been here in the last couple of years. Right, invested in sales, marketing, the Kingston facility coming online, standing up Oklahoma. We've positioned ourselves to be a much bigger company. And I think you've heard Oliver speak on the last couple calls, right? The amount of margin that drops through with a little bit of incremental revenue has been pretty impressive for us. So, I think that's the framework of all of that.

And, Oliver, maybe you want to give a few more highlights there?

Oliver Gloe
Yes sure, I think you hit it. I mean, we have reduced our cost base and are now able to supply a bigger business, right? And then that's a comment that I would say relates to the capacity we have in our plants. We're very pleased with where we are as well as the backbone we have created in the various SG&A functions. And so, that drops through to your increment on margins, on volume that comes as the market and new pool sales recover, I think will compare favorably to the decrement we've seen over the last few years.

With regards to your question about EBITDA margins of 20%, I mean we have hit a few data points over the last four or five quarters in which we have actually exceeded that. Now granted, that was towards the peak of our season in Q3 last year to 2Q to this year, but I certainly believe that with a little bit of help from the market and especially with our structurally changed cost base, 20% it is definitely our objective to return to and eventually exceed.

Ryan Merkel
Yes, that's great. Okay, that's exciting. I know we're at the end of the pool season here, but I just want to ask, when you talk to dealers, how are they feeling about next year? If interest rates come in, which it looks like they will, will you see people get off the sidelines and maybe move ahead with the pools? And, you know, also you mentioned increased spending on sales and marketing, can you talk about that and what that might mean for next year, too?

Scott Rajeski
Yes. So, you know, in terms of looking out at 2025, dealers are still focused on wrapping up the 2024 build season here. I think they're trying to get 2024 wrapped up, closed up. I mean, we hit almost 70 degrees here in Albany, New York, which this time of the year is unheard of, and we've seen continued good progress with dealers. I think I've said several times now, we don't see a scenario next year where pool starts would be down from let's say the trough of this year of, call it a 60K kind of number down 15%, which I think we kind of called early in the year. Look, I think once we see a couple things happen in the market out there Ryan, we've got to get consumer confidence back up and hopefully we clear the election here today and things are going well from there on out.

We see the Fed continue to reduce interest rates, which the indication is that we'll see another rate reduction later this week and that will continue over the next several quarters. I think we've got to get that to work through the system. I think back half of 2025, we'll see people start to kind of get back off the sidelines, jumping back in as all that works through the system. But I think overall dealers feel pretty good about 2025. I'd say better going into 2025 than they did going into 2024 just because of that expectation of the market really and current situation, shouldn't really get worse.

Oliver Gloe

If I may add to your question, building that Sand States muscle and building up SG&A, so you heard us talk about in Q3, we invested in sales and marketing. That is targeted towards the Sand States. I'd say in quarter the investment was about $1.5 million to $2 million. That's our feet on the ground leading us into 2025 and really driving that awareness and ultimately adoption of fiberglass pools in the targeted geographies, right. These are all feet on the ground marketing, very targeted marketing that depending on market feedback and we're not giving guidance on 2025 today, but that can be dialed up and down as we get feedback from the market.

Scott Rajeski
Yes, and I think one more add on to that as well, Ryan. Continue to invest in the product offering out there and the marketing initiatives. I think recently we've announced some new pools launched specific for the Sand States strategy that Oliver just mentioned. We just launched our whole new rebranding of the plunge pool lineup. Both not only for fiberglass, which we've had for a while, but also a more affordable vinyl liner lineup as well, which I think should resonate. And we also just recently kicked off a new campaign, I should say it's kind of a refresh. It's called GOOTSA, "Get Out Of The Stone Age."

So, the campaign we're running in Texas, we'll be launching it in Florida shortly as well. Again, just talking about all the benefits of fiberglass versus concrete pools and this is a cobranded effort we're doing with dealers in particular MSAs in target markets to drive the awareness at the consumer level of the benefits of that. And I think that's where we're just very focused on trying to go attack those markets where we're underpenetrated and spending money now knowing that when the recovery comes, we'll be well positioned to take full advantage of it and continue to outperform the market like we have been doing over time.

Ryan Merkel
Got it. Very helpful. Thanks so much. I'll pass it on.

Scott Rajeski
Yes.

Operator
Thank you. And our next question today comes from Andrew Carter at Stifel. Please go ahead.

Andrew Carter
Hey, thank you. Good evening. First off, I know you mentioned the hurricane, it did push some sales into the fourth quarter, push some shipments around. Could you quantify the shipments that were missed? And also, I guess with the factory down a week, were there extra costs in the quarter incurred around the hurricane? Thanks.

Oliver Gloe
Andrew, yes let me take that one. So, we saw certainly in preparation of the hurricanes and then we had Helene and Milton in the third quarter, we saw some softness, right? Plus, in addition, we had the plant shut down for a week.

In terms of quantifying between products being rescheduled from Q3 into Q4, a few cancellations, but then also softer demand, I would say it's probably between $1.5 million and $2 million in Q3, and probably at least an equal amount in Q4.

Andrew Carter

Helpful. Thank you. So, second question, I wanted to ask just going back on the gross margin profile between the product lines, could you remind us of kind of the gross margin differentials and therefore with kind of the in-ground liners or I'm sorry, in-ground pool business at I think 51% of sales versus I think peak, it was 60%? How much of a gross margin headwind that is overall? Thanks.

Oliver Gloe
Yes, well, thanks for the question. So, the gross margin profile between the various product categories, actually they're always in walking distance to each other. There isn't a lot of…that's why you never hear us talk about mix. There's really not a lot of difference between the lowest…the category with the lowest gross margin to the highest gross margin.

Andrew Carter
Fair enough. I'll pass it on.

Scott Rajeski
Thanks, Andrew.

Operator
Thank you. And our next question today comes from Tim Wojs with Baird. Please go ahead.

Tim Wojs
Hey guys, good afternoon, and likewise, just good job on the margins. Maybe just my first question, just Scott, just the Sand States, I mean, you've talked about trying to invest more there and make that a bigger part of your portfolio? Could you just kind of remind us like how big the Sand States are today, kind of relative to the existing pool market, and where you're kind of targeting those to go?

Scott Rajeski
Yes. So, I think there are a lot of different definitions out there of Sand States and what state you quantify and the exact numbers. I think we like to call it the five, right, Florida, Texas, Arizona, Nevada, and California. And look, I think we've got some pockets of decent business, and we have done a decent job in California, maybe more north than south. We've had some really decent success with a lot of our fiberglass dealers in Texas. Very little presence in Arizona, small in Nevada, and I'd say again, small in Florida. I think if you look at those states together, some folks will say it's probably 70% to 75% of all new pool starts and we tend to be underpenetrated there.

So, what we're doing right is, we said look, let's make a push. That's where our fiberglass facilities are mostly located in those areas of the country, so we should have a pretty good cost advantage with shipping getting pools into those markets. We've never really targeted these planned home communities that are out there. And look, we've just really never dedicated a lot of selling and marketing dollars to those regions. So, we've now stood up dedicated teams in those areas. We've got dedicated marketing initiatives. We've done a new blitz of recruiting new dealers into that area. I think maybe one or two calls ago, I think maybe two quarters ago, we talked about Babcock Ranch and getting a dealer from the north up here down into that market, Concord Pools.

We just co-hosted a Founders Day there in that area. And I think this will be a big push for us to really get into those markets, and show that fiberglass can resonate and again, partnering with the right dealers. And that's where we've had success in Texas, finding the right dealers who believe in the product, having the right marketing programs and doing that push. And we just felt now is the time to kind of put the focus there to try to get a higher percentage of share. And as pool starts rebound across all of North America, and we can pick up share there, that's what we're looking to kind of grow our top line and outperform market as we move forward.

Tim Wojs
Okay, that's really helpful. Thanks. And then just, I guess I know you're not giving guidance for 2025, but could you just kind of remind us or kind of outline what you kind of want to target for outgrowth relative to the full market? So, if pool starts grow 5% or something like that in any given year, just with fiberglass, and automatic covers, and some of the opportunities to get bigger in some of the larger pool markets, I mean, what should the outperformance relative to the underlying pool market be on kind of an annualized basis over the intermediate term?

Scott Rajeski
Yes. Well, it's a tough one to answer without really getting into what a guide would be. But I think if we frame it up this way, if we just kind of look at 2024, our view of market being down, say 15%, I think, you may argue and where the numbers may land at the end of the day, Tim, is it could be down maybe even closer to 20%. So, if we land at the midpoint with our guide down in the 10% to 12% range, give or take, you can kind of start to get a feel for what the outperformance is… now that's on a decline, right.

But I would think we'd see the same type of expectation on the upside. The liner and cover business with that strong recurring base of business, we'll have the auto cover business that's continuing to drive penetration and again, putting more covers on pools with the existing kind of flat base with fiberglass outperforming the market overall, so we should see an outperform overall. To peg it to an actual percentage right now, I think is a little premature, but that's kind of what we've done over the last, you can call it 13 years or so in this business is outperform both the up and the down. And that's really what the team's focused on. We are kind of really kicking off the 2025 season now as we wrap the 2024 build season up.

Tim Wojs
Okay. Okay, sounds good. Good luck on the rest of your guys. Thanks.

Scott Rajeski
Thank you.

Operator
And our next question today comes from Greg Badishkanian with Wolfe Research. Please go ahead.

Scott Stringer
Hey guys, thanks for the question. This is Scott Stringer on for Greg. I wanted to ask another gross margin question. So that's sort of been hard to pin down. Just what are the pluses and minuses for 4Q specifically? Where are you guys thinking we should be here on the street.

Oliver Gloe
And Scott you said Q3 or Q4?

Scott Stringer
4Q, so this upcoming quarter.

Oliver Gloe

Yes, so the puts and takes is, so again, we continue to estimate the year-over-year market decline as a new pool starts to be 15%. So that usually gives us about a, let's say 200 basis points of headwind here. I think the single largest tailwind is the combined impact of our lean, and value engineering initiatives that will, are almost offsetting entirely the volume impact. And then the outperformance might really come from supplier optimization where the team has done a great job of diversifying our supplier base that we are now able to leverage before, quality, supply stability but also for economic reasons and then a couple of smaller tailwinds that I would say are more under the headline of general cost control and really being diligent and disciplined on how we manage our plants.

Scott Stringer
Okay, got it. And for my follow-up question, I just saw cover sales were positive this quarter. Is that just the Coverstar acquisition or is there some sort of difference in business cycles between the segments that you guys are seeing?

Oliver Gloe
No, it's really driven by the, the Coverstar Central acquisition. Without it you see more the trends you would expect. And the Coverstar Central acquisition, as we said in our prepared remarks, the integration is going really well. You know, the back office integration, all the key activities are mainly complete with now really the planning around the revenue synergies initiatives in full gear.

We had guided last quarter that the incremental revenue is about $20 million on an annualized basis, the EBITDA percentage is about 140 basis points. We took up our guidance last time this year about $5 million. We earmarked for Coverstar Central on a net sales basis $3 million in terms of adjusted EBITDA and all of that after now I guess three months, August, September, and October, three months under the belt. I think we're confirming those assumptions.

Scott Stringer
That's all helpful. Thanks a lot.

Oliver Gloe
Thanks, Scott.

Operator
And our next question comes from Matthew Bouley with Barclays. Please go ahead.

Matthew Bouley
Hey, good afternoon, guys. Thanks for taking the questions. On your various products that go through distribution, so the liners and covers and maybe the package pools, I'm curious if you've announced any price increases into the channel for 2025? And also any color on kind of how you are treating the early buy with your distribution customers and just kind of the, you know, where they are from an inventory level and kind of what you're expecting around kind of filling the channel into the new year? Thank you.

Scott Rajeski
Yes. So Matt, we've not had any formal price increase announcements across the board out there like the equipment guys did. And I think as we've evaluated, let's say particularly the product lines that go through distribution, which is really the in-ground pools, non-fiberglass, right, the polymer and steel walls. Liners and covers are all custom, right. That's a real-time order we get those really are not stocked products.

So, we're trying to hold price there. You know, we don't really see early buys to the extent like the equipment guys do because again most of our product is custom. We are designing a kit last minute. You know, I think with the distributors, I think where we are from an inventory standpoint, looking at what they have done, let's say continue to do through 3Q, I think they are at normalized levels now of what they want to hold. And I would believe where we sit at this point is they are going to kind of play a little wait and see game, to see how the season starts in late 1Q of 2025 before they start buying to stock products for the 2025 selling season.

And look, I think the reason why they're able to maintain inventory levels low and not be placing a lot of stocking orders is our ability to serve them. You know, we are turning orders around, in some cases two or three days for pool orders so that they're getting stuff that they need. You know, clearly that will be tough to do in a peak season when it bounces back. But we've handled that all year this way. So, we don't see any more de-stocking likely to occur in that part of the channel.

Matthew Bouley
Got it, okay. Yes, thank you for that and thanks for clarifying some of what I asked there. I guess secondly on the SG&A and specifically the sales and marketing investments, I just wanted to see if you could elaborate a little on, I guess like the intention there. Just given what we said earlier, that hey, market conditions, market growth, maybe we shouldn't get too excited about a sudden inflection yet. Just kind of given we're in this bit of a kind of choppy, bouncing along the bottom type market backdrop, what's the intention around putting dollars into sales and marketing today and what are you kind of, trying to accomplish ahead of that eventual market recovery? Thank you.

Scott Rajeski
Yes. So Matt, you have been around this for awhile. It takes a while to get, let's say a fiberglass dealer stood up and up and running and on a stable basis where they can rapidly grow their install base over time. So that's where we feel now is the time to start to go find dealers. We are heading into the off season, so this is an ideal time to do boot camps, do training, get them into our dealer conference, have them attend all of our shows that we are doing. So, we can spend the next kind of say three to six months signing up, training, developing, teaching, getting leads generated, working with them with a business model, picking the right dealers in the right target markets we want to be and help them through, let's say, what would be another flat market in 2025 to get their first, kind of say, one to five pools in the ground.

What that will enable us to do is as we, let's say, exit the back half of 2025 into 2026, we should have a new established dealer base in those Sand States, fairly well trained. Let's say the next wave getting ready for 2026 and 2027. And then, our goal is to then teach these guys to get from 5 to 10, 10 to 20, 20 to 40 pools. And we just feel now is the time to position ourselves where we are set with the right builders in the right markets, with all the right marketing initiatives, all the right programs, all the right lead gen set up. So, we are not, let's say, chasing our tails when this thing does eventually turn back in part of 2025 into 2026 and 2027.

Matthew Bouley
Yes, got it. Great color, thanks guys and good luck.

Scott Rajeski
Yes. Thanks, Matt.

Operator

And our next question comes from Susan Maklari with Goldman Sachs. Please go ahead.

Susan Maklari
Thank you. Good evening, everyone. My first question is around…

Scott Rajeski
Hi, Susan.

Susan Maklari
Hi. My first question is around your capacity and utilization rates. As you think about the potential for demand to come back next year, how are you thinking about your ability to respond to that and to keep your service levels as those volumes perhaps move higher?

Oliver Gloe
Yes, great question. Thank you very much, Susan. So, a few years back when we were serving the business with $700 million revenue, you know, we were at that point in time, we had some free capacity, right? Since then, our restructuring projects took out some duplicative capacity. But then we created new capacity with the build of Kingston in Ontario as well as the extension in Oklahoma. Plus, we have created additional capacity through our lean manufacturing initiatives. That's a long way of saying that today we have, versus three years ago, we have increased not decreased capacity. And back then we were able to serve a business in excess of $700 million. So, we do have the capacity that we need as the market returns.

Plus, also the other point I make is that we have the agility that is needed to capture the additional market opportunity when the market returns. We are in a seasonal business. We are used to ramping our sites up and down. This is also a cyclical business. Today, we have industry leading lead times, and our plants have proven again their agility to cater to different demand scenarios.

Susan Maklari
Okay, that's helpful color. And then thinking about the pricing dynamic for next year, even as rates come down, there's been so much inflation that's come through over the last couple years in pools. Would you be willing to take some of that pricing off if it meant that you could perhaps get a little bit more lift on the volumes?

Scott Rajeski
Yes. So, Susan, part of, I think the magic of our business is we've been pretty successful being able to hold onto the price we push through to, let's say, distribution and our dealers. And if you remember right, we never really were able to fully offset all of the inflation we saw, let's say, to hold margin or profitability levels.

I think the other important thing to think through is the cost of our product to the end consumer, which would stimulate demand as a percentage of the total backyard pool install. If you're talking a project that's $75,000 to $100,000, our product costs as a part of that might only be 25% or 30%. So, for us to try to, let's say, push a $1,000 reduction on a fiberglass pool or a couple $100 reduction on an in-ground liner or a cover, the likelihood of that making it all the way through to the end consumer to stimulate demand of new pool installs, or liners is probably fairly small because that can easily be eaten up in the field during the build or the install with delays and weather out there. So, that's what we feel pretty good on.

But we do need to be careful with our pricing versus the competition. What the dealers are buying the product for, what distribution is passing on to a dealer. So, we kind of monitor all of that. And look, if we need to do certain things in an area, take care of one of our builders and dealers to be competitive and they think it will stimulate demand, we'll look at it. But we don't see a need to do any kind of wholesale price reduction across the board. I think it's more maybe a resetting or adjustment of what it costs to get a pool installed in the backyard. And there's a lot of other optionality that consumers can do in terms of maybe a little bit less concrete, smaller pool, maybe skimp on, let's say the outdoor kitchen or the landscaping, get the pool in proper and save $5,000-10,000 on the build in the backyard that way. That's probably the better way to do it.

Susan Maklari
Got it. Okay Scott, that's very helpful color. Thank you both and good luck with everything.

Scott Rajeski
All right, thanks Susan.

Operator
Thank you. And as a reminder, if you would like to ask a question, please press "*" "1." Our next question comes from Sean Cowan with Bank of America. Please go ahead.

Sean Cowan
Hi guys. Thank you for taking my questions. On the gross margin, the expansion was very impressive again, in the third quarter. You mentioned some of the lean manufacturing benefits and modest deflation. So, can you break out how much of the gross margin expansion was from these lean manufacturing benefits versus price cost?

Oliver Gloe
Sure. So, we are very satisfied and pleased with the Q3 performance. 250 basis points up. And this is the fourth consecutive quarter in which we have been able to report any gross margin expansion. So, to break the 250 apart, as you see the headwind, that volume, the headwind of the 6% lower volume that we saw in the quarter, that is about 150 basis points, right? So, in order for the 150 basis point headwind to post a 250 basis point margin extension, you need to have 400 basis points of good news.

About half of that is lean value engineering, okay? So that's the single largest contributor. Again, there's a little bit of deflation. Very modest, but more importantly, it's really the supply optimization, supplier management piece where we have…where we are now in a situation to have dual source on much of our supplies and we're able to leverage that, right, not only for business continuity reasons, but also for economic reasons, right? And then the rest is, as I said in one of the prior questions, is just great cost control, in-quarter cost control, really the disciplined spend levels that we have across the network.

Sean Cowan
Okay, great. Thank you. And then it doesn't sound like you guys have plans to increase prices yet, but what are your expectations on material inflation and labor inflation going into 2025?

Oliver Gloe
It's really too early to say, right? We are watching our raw material baskets very carefully, I would say, so far, in absence of considering any tariffs or inbound duties. But in absence of that, we, at this point in time, our raw material basket has actually been surprisingly stable over the last five, six quarters, right? We had modest inflation this year. And then we potentially see a modest…either stability or modest inflation next year, right? But it's really too early to tell. And

we'll come forward with a more precise view when we give our 2025 guidance the next time we are on the call and report on our Q4.

Sean Cowan
Okay, great. Thanks again.

Oliver Gloe
Thank you, Sean.

Operator
Thank you. And that concludes your question-and-answer session. I'd like to turn the conference back over to Scott Rajeski for any closing remarks.

CONCLUSION

Scott Rajeski
All right, thanks. Hey, just want to thank everyone for your time here this afternoon. We really appreciate all your continued support for Latham, and I look forward to seeing you at upcoming conferences and meetings. And if we don't, we wish you all a great happy holiday season and best of luck going into 2025.

Operator
Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines and have a wonderful day.