



**Fortune Brands Innovations, Inc.**  
**Second Quarter 2024 Earnings Conference Call**  
**July 25, 2024**

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**Presenters**

**Leigh Avsec, Vice President of Investor Relations and Corporate Affairs**

**Nick Fink, Chief Executive Officer**

**Dave Barry, Chief Financial Officer**

**Q&A Participants**

**Susan Maklari - Goldman Sachs**

**Adam Baumgarten - Zelman & Associates**

**Matthew Bouley - Barclays**

**Michael Rehaut - JPMorgan**

**Phil Ng - Jefferies**

**John Lovallo - UBS**

**Operator**

Good afternoon. My name is Sachi and I will be your conference operator today. At this time, I would like to welcome everyone to the Fortune Brands Second Quarter 2024 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

I would like to turn the call over to Leigh Avsec, Vice President of Investor Relations and Corporate Affairs. You may begin the conference call.

**Leigh Avsec**

Good afternoon, everyone, and welcome to the Fortune Brands Innovations second quarter earnings call. Hopefully, everyone has had a chance to review the earnings release. The earnings release and the audio replay of this call can be found on the Investors section of our [fbin.com](http://fbin.com) website.

I want to remind everyone that the forward-looking statements we make on the call today, either in our prepared remarks or in the associated question-and-answer session, are based on current expectations and market outlook and are subject to certain risks and uncertainties that may cause actual results to differ materially from those currently anticipated. These risks are detailed in our various filings with the SEC.

The company does not undertake any obligation to update or revise any forward-looking statements, except as required by law. Any references to operating profit or margin, earnings per share or free cash

flow on today's call will focus on our results on a before charges and gains basis unless otherwise specified. Please visit our website for reconciliations.

With me on the call today are Nick Fink, our Chief Executive Officer, and Dave Barry, our Chief Financial Officer. Following our prepared remarks, we have allowed time to address some questions.

I will now turn the call over to Nick. Nick?

**Nick Fink**

Thanks, Leigh, and thank you to everyone for joining us today.

On this call, I will walk through the highlights of our second quarter performance, give some color on the drivers of this performance, including progress on our digital strategy and offer some thoughts on the macro environment. I'll then turn the call over to Dave for a discussion of our financial results, including our updated full year 2024 guidance.

Our teams continue to execute at a high level amidst the dynamic and uneven market and delivered solid sales and strong margin results in the second quarter. Our digital products portfolio saw some exciting wins this past quarter and we are seeing accelerating growth in this key market, which I will detail shortly.

The benefit of our organizational realignment continues to generate real results as evidenced by our market beating sales and margin performance this quarter. These actions all support our position as a growth-focused company, powered by secular tailwinds, underpinned by leading brands, innovation, and channel management, and fueled by our Fortune Brands Advantage capabilities.

Turning to our second quarter performance. Our teams delivered solid top line and strong bottom line results with areas of organic growth in our core North American market. Net sales of \$1.2 billion were up 7% while organic sales were \$1.1 billion, down 3% versus the second quarter of 2023. Excluding China, which was impacted by lower sales as the Chinese consumer remained very cautious, our organic sales growth was positive in the second quarter, including low single-digit growth in our Outdoors segment and Moen North America.

Looking to the remainder of 2024, we expect continued outperformance in our Moen North America and Outdoors business as well as accelerated growth in our digital portfolio. Our operating income increased 9% and our operating margin was 40 basis points higher than the second quarter of 2023, bringing our year-to-date operating margin improvement to 110 basis points. Our sales and margin performance generated earnings per share of \$1.16 in the second quarter, an 8% increase over the second quarter of 2023.

Turning first to our digital portfolio. We saw approximately 200,000 device activations in the second quarter and the overall digital business continues to accelerate. In the second quarter alone, we added around 20,000 users of our Flo Smart Water Monitor and Shutoff and retail and e-commerce point-of-sale performance far exceeded our expectations as the consumer increasingly gains awareness of this powerful product.

Perhaps even more importantly, during the second quarter, we achieved several significant milestones across our digital portfolio, which will accelerate our overall strategy. Our digital business is now expected to add over 150 basis points of organic sales growth to the second half of 2024, and which we expect to accelerate in 2025, as the newly established partnerships continue to ramp and awareness increases.

We see a path for well over \$1 billion in digital sales by 2030. We're also evolving our revenue opportunities towards data monetization and reoccurring revenue, which will provide incremental growth and further margin expansion opportunities as we continue to scale.

First, we announced key partnerships with several large insurance companies this quarter, including entering into a nationwide agreement with Farmers Insurance to provide Flo Smart Water Monitor and Shutoff devices to their customers. Under this agreement, Moen is providing farmers policyholders a bundled product and installation solution supported by dedicated infrastructure, which will allow policyholders to save money on their premiums.

This agreement will be especially impactful in states like California, where farmers and other insurers are now requiring a significant number of new and renewing policyholders to equip their homes with an in-line leak detection system. After this new requirement went into effect, farmers sought out a partner to create a seamless customer experience for the purchase, installation, and support of an In-Line Water Monitor and Shutoff device.

Moen won this precedent setting opportunity because of our exceptional product, ability to deliver last mile installation at a national scale, and our brand's reputation for quality, service, and innovation.

Importantly, we were also selected as the Partner of Choice because of our ability to scale our supply chain as this opportunity grows, and we are already preparing for rapidly accelerating growth.

In addition to Farmers Insurance, this past quarter alone, we have signed three other agreements with insurance companies where the providers will promote the use of our Flo in connection with sizable policy rate reductions for their policyholders. Our pipeline of insurance discussions is robust, and we expect further progress throughout the year.

In June, we also announced an agreement with the California Water Efficiency Partnership, which will help us raise awareness of Flo directly with municipalities and residents across California and will facilitate government rebates of our Flo devices.

As water scarcity becomes a major concern in California and beyond, we expect this partnership will help accelerate both sales and awareness of Flo and serve as a template for other similar partnerships across the United States.

In addition to the added expected revenue and exposure to our products, these agreements are important because they prove we can help enable the insurance industry to mitigate risks and issue cost-effective policies as they face a crisis of rising costs. In doing so, we can also help their customers save money and avoid disruption by preventing catastrophic water damage. And of course, these partnerships benefit our communities and environment by reducing wasted water and energy.

Finally, enacting agreements like the one with Farmers Insurance or California Water Efficiency Partnership, requires us to quickly and effectively work across our full organization from our sales and marketing teams to our connected products group to our supply chain and digital teams. These agreements are yet more proof points of how Fortune Brands Innovations new organizational structure is enabling us to capture opportunities at an accelerated rate.

In addition to our agreements centered on smart water leak detection, we also recently announced a minority investment and strategic partnership with Value Hybrid, a leading software startup focused on the delivery of connected lockout tagout solutions. This partnership will expedite Master Lock's ability to bring to market new and innovative products in the emerging field of connected lockout tagout and expand our leadership position in commercial safety solutions.

Connected lockout tagout is a significant and attractive opportunity for Fortune Brands. Given our highly recognized Master Lock brand, large installed base, and lockout tagout expertise, we are very well positioned to convert mechanical lockout tagout systems to connected lockout tagout solutions and grow the addressable market.

We estimate that the global addressable market for connected lockout tagout is around \$3 billion as keeping associates safe is an increasing key priority for manufacturers and regulatory agencies across the globe.

And finally, we are excited to announce that we recently entered into a new partnership with ADT. Under this agreement, the Yale Assure Lock 2 collection will be the preferred smart lock for ADT customers across the country. The lock collection will be compatible with the ADT security platform, including the ADT+ app, within which ADT will launch a new feature called Trusted Neighbor.

This innovation allows customers to seamlessly grant trusted individuals secure and temporary access to their homes through either scheduled access or in the case of events by leveraging capabilities of connected home devices including our Yale Smart Locks.

Once again, this agreement is a great example of the potential of our connected product portfolio as we are increasingly exploring new channels and distribution partners to accelerate growth. These are just some of the many examples of how our digital portfolio is expanding and I am encouraged and excited by our unique right to win in this exceptionally high-growth space.

While we cannot predict the exact timing or trajectory of our digital products, we believe periods of exponential growth will be preceded by key milestones like the ones we saw this past quarter. These milestones are significant, not just for the revenue that they are expected to bring in, but also because they represent key foundational steps in our journey toward widespread adoption of our products.

Our results this quarter and the exciting developments that we are seeing give me full confidence in Fortune Brands Innovation's ability to deliver growth and sustain value creation through the cycle, and we remain committed to achieving our long-term goals.

Turning now to some additional thoughts on the current housing market and the market for our products. On a macro level, favorable long-term housing fundamentals remain in place with the need for housing

remaining strong, home prices largely holding steady, and equity levels remaining high. Importantly, inflation appears to be easing and the likelihood that the Fed will lower interest rates in the coming months is increasing.

However, we are aware of offsetting factors in the very near term, including consumer confidence and continued affordability challenges. We expect many of these macro trends will inflect positively soon, and until we see tangible evidence of improvement, we will continue to manage the business tightly.

Looking at our products specifically, we believe that we are well positioned. We have strong brands in categories where brands and innovation matter. Most of our brands do not play in opening price points, which tend to be more sensitive to pricing pressures. And finally, we are strong with the Pro, and Pro led projects have held up better than DIY.

Turning to new construction, single-family new construction remains strong and large production builders remain optimally positioned to continue to be able to address the need for housing, and we are a trusted partner to a very significant number of these homebuilders.

This quarter, we continued to see encouraging growth in our products, which serve the single-family new construction channel, including Moen and Therma-Tru. We expect this tailwind to remain through 2024 as builders complete their starts.

Turning to R&R. Consistent with what we anticipated, the R&R market has stabilized, but at a level still below prior year and we expect the R&R market to remain dynamic throughout 2024. However, there are some positive leading indicators in the R&R space. Google Search results show that search terms around home renovations are once again up versus a year ago, indicating the continued interest in our products with particularly high increases in searches around connected home products. Existing home sales, while not a major driver of our R&R sales are expected to improve versus the continued softness we have seen year-to-date.

Finally, as interest rates recede, HELOC loans may be increasingly utilized as they enable consumers to leverage high equity levels to make significant upgrades to their homes.

The market in China continues to remain challenged. As a reminder, the impact is isolated and independent from the rest of the portfolio and the China business provides attractive optionality for growth and innovation. We continue to replatform the business and will be well prepared for R&R led growth once the market recovers.

We believe that our brands and products are well positioned to outperform, including in the current dynamic and uneven macro environment. We saw examples of growth in many core and new product areas and we will take advantage of the current period to further align our business behind those areas with higher growth opportunities, including investing in a key set of strategic priorities, while also continuing to optimize our business to be even more agile and efficient.

Turning now to our individual business results. Starting with Water Innovations, this segment delivered 7% sales growth versus the prior year quarter, with organic sales down 5%, while generating 10 basis points of operating margin improvement.

Excluding China, our Water segment saw excellent performance in an uneven market with organic sales up low single-digits, led by Moen North America. Our core Moen business continues to outperform the market and take share, particularly in our wholesale business. Recent consumer brand metrics data indicate that we continue to be the highest rated brand for both quality and innovation.

Our point-of-sale from Moen North America saw impressive mid-single-digit growth with all channels showing growth, outperforming a larger market for our products, which we believe was down low single-digits. Our strong relationships with the largest production national homebuilders are expected to be a tailwind for the Moen business throughout the remainder of 2024 and beyond.

Our US luxury business again performed well as the luxury consumer remains more resilient. Our House of Rohl brand is number one with designers in awareness and consideration, and brand perception data indicates that we also lead our peers for luxury, trust, and innovation. Our point-of-sale for our House of Rohl business was roughly flat year-over-year versus the market which we believe was down mid-single-digits.

We are now one year into our acquisition of Emtek and the work to integrate the brand into our comprehensive and complementary luxury portfolio, including showrooms, is progressing very well. As I mentioned earlier, Flo by Moen continues to gain traction with insurance companies, municipalities, and consumers.

While the new insurance and municipality partnerships are beginning to ramp up, our retail and e-commerce point-of-sale accelerated 130% in the second quarter, highlighting the continued adoption by consumers. We expect sales of our connected water business to accelerate through the back half of 2024.

Finally, China sales were down more than 35% this quarter as the Chinese consumer remains cautious. Our team in China has done an excellent job managing costs and margins.

Looking to the remainder of 2024, we expect our Water segment to continue to execute on our commitment to deliver above-market sales performance by focusing on those parts of the market with the greatest potential for growth. We plan to continue to make thoughtful investments in our key priorities, including branding and digital initiatives. We remain very excited about our water business, particularly the opportunities we see to capture growth in digital, luxury, and water filtration.

Turning to Outdoors. We had a strong second quarter with 4% sales growth and operating margins that improved sequentially over 420 basis points. We continue to focus on leveraging our expertise and investing behind our core categories and in those areas which we expect will offer the most attractive growth opportunities. Our Outdoors business has exposure to many key secular growth tailwinds including material conversion in our fiberglass and composite decking businesses, outdoor living and even luxury as we increasingly integrate our solar innovations technology and our Emtek products into Outdoors.

Outdoors brands delivered mid-single-digit sales growth as tailwinds from new construction and recent retail wins continued to drive sales. Therma-Tru continues to see the benefit of the increase in starts and

completions, which began last year, and Larson is seeing nice performance as we begin to see the benefits of new innovation.

Decking sales were up low single-digits in the quarter, and once again, our Fiberon business is a great proof point of the power of our strong wholesale channel relationships. Like our leading Therma-Tru business, our Fiberon business has a strong conversion story backed up by strength with the Pro and the Fortune Brands expertise in multichannel distribution. We are seeing encouraging brand metrics, especially with the Pro and continue to be excited by the ability of this product to harness the powerful secular tailwinds of material conversion, sustainability, and outdoor living.

Finally, turning to our Security business. Our Security segment grew sales 12% in the quarter and was down high single-digits on an organic basis, primarily due to continuing softness of consumers in retail and e-commerce. Encouragingly, we saw improving point-of-sale as the quarter progressed.

The segment also saw 330 basis points of operating margin improvement, inclusive of the technology investments in the Yale and August residential smart lock brands as the work we did around continuous improvement and supply chain continues to payoff. Our Master Lock brand is incredibly strong and we believe our recent organizational redesign will allow us to further strengthen this powerhouse brand.

Finally, our Master Lock's Security business is now around one-third industrial and commercial and we have developed a niche in the critical and growing remote access portable security space across the globe.

We are proud of how our business is helping companies around the world to protect their people and their assets. As we accelerate our leadership in connected industrial security for our lockout tagout investments, we expect this portion of the business to see future outsized growth.

Over the past few years, we have evolved from mechanical only products into innovative and growth-oriented businesses with a much more strategic portfolio. We will reinvest the efficiencies gained from our recent optimization of the business to leverage strong secular trends like digital products and safety.

As a result of our new aligned structure, we have substantially improved the segment's supply chain and sourcing capabilities, accelerated our branding work, and have made significant progress in building our digital security portfolio.

A year into the acquisition of Yale and August, we are delighted with these accelerants to our business. In addition to being great assets, which we acquired at a very attractive price, we continue to be impressed by the strength of their teams in key areas, including digital. We are utilizing their skills and knowledge throughout the business and their expertise is being deployed across our portfolio as we continue to accelerate our digital strategies.

In 2022, our digital security sales comprised just 2% of the segment's sales. This past quarter, they represented close to 20% of security sales and we see a pathway to over 40% of this segment sales coming from digital products as we continue to convert mechanical products, the digital products, and explore new-to-world technology in our spaces.

As we turn to the second half of 2024, we remain fully confident in Fortune Brands' ability to deliver above-market growth, drive margin improvement, and continue the acceleration of our digital portfolio.

Looking at our end markets, US single-family new construction and luxury continue to be tailwinds, R&R has firmed, though not yet improving year-over-year, and China is weaker than expected as the push to complete homes has ended and the Chinese consumer remains cautious. We continue to lead through the current environment well while still investing in critical priorities like our digital strategy and our brands and innovations.

To recap, in the second quarter, we executed our priorities of focusing on the core and accelerating digital products and delivered impressive organic growth in our core Moen North America and Outdoors businesses. In doing so, we delivered solid sales and strong margin results.

We will continue to strategically manage the business in light of the uneven market backdrop, and we'll focus on those areas where we have the greatest potential for above-market growth while continuing to make margin improvements. By taking decisive actions now, I believe we will be best positioned for accelerated growth when external market conditions improve.

I will now turn the call over to Dave.

### **David Barry**

Thanks, Nick. As a reminder, my comments will focus on income before charges and gains to best reflect ongoing business performance. Additionally, comparisons will be made against the same period last year, unless otherwise noted.

Let me start with our second quarter results. As Nick highlighted, our teams delivered solid sales and strong margin results amidst the dynamic external environment. We remain well prepared for any macro environment and are positioned for future growth as we focus on our core and accelerate digital while continuing to generate cash and make key strategic investments.

In the second quarter, sales were \$1.2 billion, up 7% and down 3% excluding acquisitions, organic sales, excluding China, grew 1%, consolidated operating income was \$216 million, up 9%, total company operating margin improved 40 basis points to 17.4%, and earnings per share were \$1.16, an 8% increase versus last year. Our second quarter sales performance was driven by US POS growth in Water and Outdoors as well as digital products, offset by POS declines in security and China softness.

Let me provide more color on our segment results. Beginning with Water Innovations, sales were \$660 million, up \$43 million or 7% and down 5%, excluding the impact of acquisitions. Excluding China, organic sales were up low single-digits. Importantly, our organic sales results reflect mid-single-digit Moen North America POS growth. China sales declined more than 35% as the Chinese consumer remain cautious.

As a reminder, our results this quarter also reflect the impact of lapping last year's project completions. We continue to replatform the business toward an increasingly R&R led market so that we are prepared for growth when the market recovers.



Water Innovations operating income was \$153 million, an increase of 7%. Operating margin was 23.3%, an increase of 10 basis points, and we expect to continue to make sequential margin improvement through the second half of 2024.

Turning to Outdoors. Sales were \$389 million, up 4%, driven by growth in both doors and decking. Door sales increased mid-single-digits. Sales were supported by higher volumes at Therma-Tru, driven by the increase in single-family new construction and recent retail placement wins. Decking sales were up low single-digits, driven by continued strength in wholesale and partially offset by anticipated declines in retail.

Our results this quarter reflect our ongoing strategic approach of focusing on those core categories in which we expect to have the best opportunities to achieve long-term above-market growth and profitability.

Outdoors segment operating income was \$63 million, up 3%. Segment operating margin was 16.3%, down 10 basis points. We expect Outdoor's second half operating margins to average around 15.5% and improved sequentially, as favorable production costs hung up in inventory will flow through the P&L.

In Security, our second quarter sales increased 12%. Organic sales decreased 7%, reflecting soft POS particularly in retail and e-commerce. Our POS trends improved in late June and early July, giving us confidence in our full year outlook.

We continue to see momentum in the categories we have identified as having higher growth potential such as Master Lock commercial and our digital Master Lock and Yale products. Segment operating income was \$36 million, up 36% and segment operating margin was 18.9%, an increase of 330 basis points.

Our organic operating margins were greater than 21% with over 500 basis points of improvement over last year, driven by continuous improvement initiatives. As we have discussed previously, we think our Security segment is a great example of the power of our Fortune Brands advantage capabilities and we expect great things from this business.

Turning to the balance sheet. Our balance sheet remains solid with cash of \$353 million, net debt of \$2.5 billion and our net debt-to-EBITDA leverage is 2.6 times. We remain on track to achieve our target net leverage ratio of around 2.25 times by year-end. We have \$1 billion available under our revolver.

In the second quarter, we returned \$85 million to shareholders via a combination of share repurchases and dividends, including \$55 million of share repurchases. As of today, we have repurchased \$190 million of shares this year. Our second quarter free cash flow was \$223 million, exceeding our expectations.

To summarize the quarter, we delivered solid sales and strong margin results and are on the path of delivering our full year commitments to grow sales above market, expand our margins and generate cash. We are pleased with our first half performance while being aware of the dynamic macro environment. And as you saw in our earnings release, we have updated our full year guidance to reflect our current view of market conditions, including a stronger US single-family new construction market and strength in our digital businesses, offset by a weaker market in China.

Importantly, we are narrowing the range around our prior EPS midpoint as growth in our core businesses, acceleration of our digital products, and margin delivery gives us confidence in our ability to deliver these results.

For the remainder of 2024, we now expect the global market for our products to be down 3% to down 1%, with the US market down 1% to flat. Within this market forecast, we expect US R&R down 4% to down 3%. US single-family new construction to be up between 8% and 10%, with starts up high single-digits and completions up low single-digits. And the China market for our products to be down 20% to down 15%.

Within this backdrop, we now expect full year Fortune Brands sales to increase 2.5% to 4.5% and organic sales to be down 2% to flat. This revised figure reflects continued strength in our core North American businesses, including Moen and Therma-Tru, strength in our luxury business, the benefit of our SpringWell acquisition, and an accelerating digital business, offset by China.

We now expect our full year operating margins to be between 17% and 17.5%, the midpoint of which is 125 basis points above full year 2023. We are confident in our ability to hit our margin guidance and have good line of sight to a number of productivity initiatives, which will benefit our margins across the second half, particularly in our Outdoors and Water segments.

Our commodity costs are largely set with relatively small exposure to freight volatility and we expect to remain price cost favorable for the full year. Based on our revised guidance, looking to the second half of the year, we expect slightly positive sales growth with operating margins of around 18%.

As a reminder, we closed on our Yale, August, and Emtek acquisition in June of last year and the performance of those brands will be included in our second half organic results.

To sum up, our teams delivered a first half of the year ahead of plan and will remain focused on the execution of our key priorities. I am increasingly excited about the opportunities ahead of us as our business transformation continues to accelerate.

I will now pass the call back to Leigh to open the call for questions. Leigh?

### **Leigh Avsec**

Thanks, Dave. That concludes our prepared remarks. We will now begin taking a limited number of questions. Since there may be a number of you who would like to ask a question, I will ask that you limit your initial questions to two and then reenter the queue to ask additional questions.

I will now turn the call back to the operator to begin the question-and-answer session. Operator, can you open the line? Thank you.

### **Operator**

Thank you. If you would like to ask a question, please press star one on your telephone keypad at this time. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue. For participants using speaker equipment, it may be

necessary to pick up your handset before pressing the star keys. Again, that is star one to register a question at this time.

The first question is from Susan Maklari of Goldman Sachs. Please go ahead.

**Susan Maklari**

Thank you. Good afternoon, everyone.

**Nicholas Fink**

Hey, Sue. How are you?

**Susan Maklari**

I'm good, Nick. The stat that you gave on the digital initiatives are very impressive, so I'd like to start there. Perhaps, can you quantify the impact of those partnerships that you mentioned over time? How do you think about the opportunity relative to the business today and the ramp that you look for as you target that over \$1 billion of revenue by 2030. And then maybe within there, can you also talk about any implications for margins, both in the near term as these sales start to come through and then over time?

**Nicholas Fink**

Yes, absolutely. Why don't I try to break it down a little bit and give some perspective on that and Dave can round out some of the numbers. So I'll just start with the entire digital portfolio. So when you think about that, right, it's both in water and security. Obviously, Flo in the whole ecosystem that goes around Flo security, it's connected, Master Lock, it's connected, lockout tagout where we're increasingly excited about the opportunity in commercial security. And then, of course, Yale and August and connected access and everything that gives us over there.

I'd kind of start maybe with the headline answer to your question, which is dimensionalize what the opportunity is and where we start to see it. And as I said, in my remarks, we see the opportunity being well over \$1 billion by 2030. And you're seeing the impact now, right? As we said, 150 basis points of growth we expect to come for the whole portfolio -- Fortune Brands portfolio just in the second half alone. And so we've been working on this for a while and trying to drive it to a momentum point. And now when we've seen that much impact on total company growth, knowing that this is a very rapidly compounding space as well. I think we're at a tipping point where you are starting to see some material impact on both top line and then we'll dimensionalize the margin question for you.

When you break down specifically about the partnership. So you break down the Flo by Moen opportunity. And I think about it really in kind of three big pillars of route to market today. One is, call it, the straight-to-consumer route to market, driven by consumer awareness of the issue that is there to solve the disruption to their lives. There's the insurance where we know there's in excess of \$15 billion of addressable water damage that we can literally take to almost zero on a per annum basis just in the United States. And then of course there's the municipal channel, where we know not only is there a lot of water lost through addressable leaks, the cost of cleaning, treating, and distributing that water in terms of carbon is very big.

Just as we said in the quarter, I mean, the retail piece, I would say, you expect it to sort of grow steadily with consumer awareness over time. Point-of-sale was 130% in the quarter, which is more than a steady

increase. And so we really believe that there is starting to be increasing consumer awareness of this and they are going and seeking the product out. So we are very excited to see that.

Insurance, this -- we've been working on insurance for a while and we've been working with insurers to assist the availability of their product. The reason that this quarter was such a milestone was because it was the first time that you saw and ensure move on mass towards mandating the product, not just sort of unexception, but more generally across a huge segment of their portfolio and really looking to the market for a partner that can help them do that. And in order to do that, you needed a partner that had a best-in-class product, could step up an entire system with nationwide installation, be able to provide back-end support, dedicated landing pages, and have a supply chain that we could ramp very quickly to do that.

I'm immensely proud that our organization in a very short amount of time could pull all that together. And I think it speaks to the alignment we've driven across the Fortune Brands Org over the last few years and some of the organizational design work we've done to really unleash it.

And then the third pillar is municipal that CalWEP agreement that I described, where we really are going to open the platform of government rebates, which are pretty plentiful out there, make it really easy for consumers and consumers to access the municipalities to drive that purchase was very exciting. And a) for California, but b) I think it's really going to be a national template for how this is going to work going forward. And so you put all of that together, the point I was trying to make is great growth, but more importantly some really, really milestone steps that we believe will drive an inflection in the growth that we're going to see in this portfolio.

And just before I turn it over to Dave to talk about margins and maybe I mentioned some of the numbers, I'll just add one other thing, which we also talked about the connected lockout tagout deal that we did with Value Hybrid. And I don't want to understate the size of that opportunity. I mean, that is making people safer in manufacturing facilities around the world. And you can just start to think about the size of that market. We have the leading product plus software platform in the marketplace and going to drive the transition of that from mechanical to connected. So another huge win driven by the same underlying digital team that we've now put in place across all of our portfolios. So a really big quarter from us strategically in driving this portfolio. And with that, I'll let Dave run to that.

### **David Barry**

Yes. Thanks, Nick. Sue, I think the market has been looking for material proof points that the strategy is working and now we have a handful of them that are material. So I think you can sense our excitement, it's early days of the ramp of each of these opportunities, but still meaningful to our overall growth in the second half. As Nick mentioned, the 150 basis points of growth across the second half, it's probably skewed a bit more towards the fourth quarter, closer to 200 basis points of growth in the fourth quarter.

And then each of these agreements and partnerships are margin accretive. I mean as we've talked about in the past, our connected product portfolio is margin accretive relative to the mechanical portfolio and then the nature of these agreements many of which are direct selling opportunities are margin accretive relative to the base portfolio. And that's a bit of what's driving some of the incremental margin coming through in the second half as these opportunities ramp. We'll continue to invest in the flywheel of the connected products business and also be able to have nice leverage from these opportunities.

**Susan Maklari**

Okay. That's great color. Thank you both. And then maybe shifting a little bit more to the near term and thinking about the back half. The back half guide seems to imply some relative conservatism perhaps or a bit more conservatism. And that seems in contrast to the second quarter results and the commentary that you gave. Can you talk a bit about how you're thinking of the health of the consumer? What's making you a little bit more cautious on the third and the fourth quarter outlook there? And does it vary by price point or by product category? Just any details that you can offer on that?

**Nicholas Fink**

Sure. I'll just give some high-level perspectives and I'm sure Dave will add some color. Look, I think it is still wise to be cautious about the consumer. I think you're seeing that across industries. I mean there's been choppiness not just in our industry, but in others. Interestingly, it is a little bit a tale of two cities. We see choppiness in some areas. As we said, we've seen retail kind of steady out, not yet quite recover, but seem to have found a baseline at least for our business. But with, I would say, we're sort of where we thought we would be, not quite where we hoped is the way I think about it. And so we're sort of in line with what we had forecast maybe a bit weak certainly on the China front, but better on the single-family new construction front.

But with that, I think it still is wise to be cautious, particularly as we go through the third quarter and await for this ramp up the connected products I was talking about. That said, I do think that the consumer is very sensitive from a confidence perspective to news around inflation and rates. And I do think as that improves, we do see proof points that they were done very quickly as they did in the beginning of the year to that kind of news and information. And so to me, I would look for that to start to see a bit of an inflection around the recovery.

**David Barry**

And, Sue, I'll provide -- let me provide a bit of context around the second half as I think some of the phasing might be counter to what you typically expect as these opportunities ramp and there are some comp dynamics to sort through. So if we look at the second half, I'd expect third quarter sales down around 2.5% and fourth quarter sales growth of 3%, of which about 200 basis points of that is connected.

So the third quarter looking pretty similar to the second quarter, as Nick kind of alluded to, and then as we move to the fourth quarter, that connected growth, we have continued single-family new construction completions, which have lagged starts and we'll be having a -- it will be a soft comp on the new construction side there. And then we have some previously awarded product placements that will set in the fourth quarter across the business. And so some really strong reasons to believe in that sales phasing as we move through the period.

And then with that sales phasing operating margin, we expect actually will be higher in the fourth quarter, probably closer to 18.5% than in the third quarter, where we're expecting something closer to 17.5%.

**Susan Maklari**

Okay. That's very helpful. Thank you both and good luck with everything.

**Nicholas Fink**

Thanks.

**David Barry**

Thank you.

**Operator**

The next question is from Adam Baumgarten from Zelman & Associates. Please go ahead.

**Adam Baumgarten**

Hey, guys. A quick question on security, really strong margins in the quarter, but it looks like based on the full year guide, maybe those are stepping down a bit in the second half. Maybe if you could walk through some of the dynamics there?

**David Barry**

Yes, Adam, as we've talked about, really strong margins, especially organically in security. We've replatformed the cost basis there in that business, and we're starting to see those results, which we expected. With Yale and August included in that, there will be periods of reinvestment back into that business. We'll also reinvest back into Master Locking. So you may see some periods of just margin volatility that will signal as we make some of those bigger investments back into the brands and to drive the product.

**Adam Baumgarten**

Okay. Got it.

**Nicholas Fink**

The only thing I would add, Adam, about that margin journey is huge progress, obviously, on the organic margin and the cost base of the business. Of course, we like profitability, but really, we believe that this business will be a growth platform and you can invest behind profitable growth platform. So the motivation-- the strong motivation of the team to get it to the point where we're not getting it is so that we can start to invest in this connected and commercial journey that we see while driving margin improvement for the business and investors, but really create the fuel to drive top line as well.

**Adam Baumgarten**

Okay. Got it. And then just on the Flo business, those three pillars to market that you spoke about maybe where you see the biggest near-term opportunity within those three over the next year or two?

**Nicholas Fink**

Yeah. I would say it's really in that insurance pillar. I think the consumer is coming along even quicker than I might have expected at the growth rate that I was describing. But there is such a huge opportunity in insurance. And if you talk to property insurers today, it's a little bit of the same path as health insurers started down the path a few years ago. They are no longer just risk pricers, they really do need to mitigate downstream risk and take cost out of the system in order to offset the cost of insurance.

I mean I think since 2021, the average US homeowners insurance is up about 30%. I think it's 27%. So there is a need to find ways to take cost out. We have a product that takes \$15 billion plus of annualized cost close to zero. And so I think you'll start to see that be the fastest and largest driver as insurers start to gain

confidence in this as a proposition and move towards mandating it just as they might a fire suppression or alarm system in your house.

**David Barry**

And Adam, I would just add, as I think about it simply, the insurance opportunity is really about two things. One, being able to offset unknown risk from storms, fires, etc. with known risk reduction, which is preventable water damage. And then two, lowering the affordability of homes, as Nick mentioned, because now you're able to price risk better to homeowners and consumers and one, offer them insurance, and two, offer them insurance at a better rate, which helps overall affordability. So we're excited about the early progress here and where this is going to go.

**Adam Baumgarten**

Great. Good to hear. Thank you, guys. Best of luck.

**Nicholas Fink**

Thank you.

**Operator**

The next question is from Matthew Bouley from Barclays. Please go ahead.

**Matthew Bouley**

Good evening, everyone. Thank you for taking the questions. I wanted to touch on the US single-family new construction end market. It looked like, of course, you raised your guidance for the year just for that particular end market. Obviously, if you look kind of high level, there's been a little more chop in starts and new home sales and homebuilder order results. So maybe it's a little bit of timing difference going on, but I'm curious if you can kind of unpack that a little bit. What exactly are you seeing in single-family new construction and kind of what gives you the confidence there to increase the guidance for the year? Thank you.

**David Barry**

Hey, Matt. Yes, you're correct to point out the original guidance through this segment up 5% to 7%, and now we see it up 8% to 10%. And I'd remind you, when we speak to the market, we're speaking to the market for our products and when we anticipate them being consumed. And so here in this segment, we do have a lag typically from a start to when our product is consumed. And for water, for instance, it's closer to completion, for doors that comes more in the middle.

And so as we look at, you know, first half starts were up 17%, completes were only up 1%. And while it seems like the builder orders, to your point, maybe softened a bit, there's still some growth and then we have that tailwind of starts and completion gap to take us through the second half. And so that's really what gives us confidence in this segment continuing to perform through 2024 and beyond.

**Matthew Bouley**

Got it. All right. Cool. Thank you, David. Secondly, I think you made a comment at the top around sort of confidence in the ability to hit margin guidance. I believe you mentioned some productivity to come in both Outdoors and Water. So as we kind of think about the second half, I heard you loud and clear that you'll have some of that kind of margin accretive sales coming with the connected products as well. But as

we kind of think about the sequential improvement in margins in the second half and water margins implied to be above 24%. Same question kind of unpack that and what specifically are you expecting on the productivity side that could support that margin ramp? Thank you.

**David Barry**

Yes. So we have really good visibility into what's on our balance sheet. And our plants have been running well and we have some favorable costs that's going to flow through the P&L in the second half. And so we'll see that come through. I think it's in Outdoor, it's in Water. We also have favorable product mix. So as we have -- the digital growth and then incremental placements with some innovations that are going to be margin accretive, we'll see that come through in the second half.

And then we're continuing to tightly manage our cost base until we see broad-based volume recovery -- we've definitely seen pockets of growth, but until we see more broad-based, we'll be tightly managing costs. And so I think those factors together give us confidence as we sit here today in the margin appreciation across the second half of the year.

**Matthew Bouley**

All right. Thanks, Dave. Good luck, guys.

**David Barry**

Thank you.

**Operator**

The next question is from Michael Rehaut from JPMorgan. Please go ahead.

**Michael Rehaut**

Hi. Good afternoon. Thanks for taking my questions. First, I know, obviously, it's a multiyear ramp and we've talked a lot about digital and connected I would like to try and get a little more granular if possible and recognizing that there's a lot of white space and opportunity over the next several years. But as you're starting to kind of ink some of these initial deals and start to, you know, the strategy becomes more and more clear, I was just hoping to get a sense for, number one, across Water Innovation and Security, what percent do you consider digital or connected today of your sales? I think you threw out a 20% number for security. And more importantly, as we think about the contributions to sales growth in '25 and '26, what type of above-market lift might we expect as these different products gain momentum, i.e., Flo and insurance and lockout tagout and other initiatives on the security side?

**David Barry**

Hey, Mike. It's Dave. So as we think about the size of this business today and where it's going, I think a helpful reference point as we look at what we expect in the third quarter, will now be annualized sales north of \$300 million. This is up -- the last number we gave was we were approaching \$250 million. And so we're starting to see that step change in growth. I think that will be a metric we continue to follow because it's really hard as fast as things are moving and growing for us to give a retrospective view. I think it's more about what's happening in the quarter and where do we see it going from there. As we look to '25 and '26, as we talked about, the growth will be 150 basis points in the second half of the year at the early days of these initiatives and trust that the team has a full list of opportunities and the pipeline remains robust and



active. And so we expect it to continue to accelerate. So as we look to drive continued above-market growth. I think this is just the tip of the iceberg for what we will execute on over the next two years.

### **Michael Rehaut**

Great. Now that's -- it's obviously really interesting and a huge opportunity over a number of years so look forward to hearing more about that. Secondly, maybe just to kind of dive in a little bit to some of the changes in guidance by segment. If you could kind of maybe break out the drivers behind the improved margin outlook for Outdoor as well as the reduced outlook for security sales, which seems to be coming more from the acquisition piece rather than the organic piece. And I know, obviously, this quarter was a bit below our estimates in terms of the top line. So just trying to understand, number one, the drivers of the improved margin outlook for Outdoor and if that's sustainable and kind of a new baseline for the company going into next year and then kind of the drivers behind some of the volatility in the acquired sales, I guess, in security this year.

### **David Barry**

Yes, happy to. So on Outdoors, I'd say two things. So one, we took the sales up a little bit and that business is the most vertically integrated. We'll have some additional volume leverage coming through. And then as I mentioned, the plants have been performing well, especially within our doors business, and so it's driving some favorable lower cost inventory that's on the balance sheet coming through the P&L as we sell through the back half of the year. So we have good visibility to both of those things that will drive margins.

And then on security, the sales adjustment down is really POS driven, I'd say, predominantly through the first half performance. And importantly, as we looked at our trends late into June up until the call, we've seen POS recover across that business and kind of gives us confidence in our full year outlook there for security. So it's really first half softness in Master Lock.

### **Nicholas Fink**

And I'll just add a couple of things to round out your question. With respect to Outdoors, as we said at our Investor Day, and I'm going back a little while, I mean, this was part of the margin improvement journey as we thought about the footprint and making that business more efficient. And so absolutely expect this, you know, it's not total straight line every quarter, but do expect that we are continually moving this business towards the endpoint that we communicated, and it's tracking really well.

And then just on the security side, as Dave said, kind of a pure retail e-com part of Master Lock is where we saw some POS softness and as Dave alluded to improved towards the end of Q2 and into July. So that, it was good to see that improvement.

And then the acquired business actually performed pretty well. What we've learned about it as we've gone through time is it's sort of a very big deal, a big deal on top of POS. And so you'll lap some big deals at times. In which case, it may feel like it's pulling back and then you're signing big deals at other times. And so I think we had some laps here, but at the same time, we just announced that ADT deal. Those sales aren't really yet pulling through. And so that would be an accelerant. As the business grows, it will get a lot smoother because it will be less dependent on some big partnerships that we announce from time-to-time.

**Michael Rehaut**

Great. Thank you.

**Operator**

The next question is from Phil Ng of Jefferies. Please go ahead.

**Philip Ng**

Hey, guys. Mid-single-digit organic growth in Moen North America is actually really impressive. Any color on the split between volume versus price? And do you actually see that business accelerating in the back half? Because there is a decent portion of single-family. It seems like you're expecting that to kind of firm up.

And then on the flip side, China was obviously weaker than we all would have hoped. Are you starting to see that business bottom out? I just wanted some color in terms of intra-quarter trends and how you think about the back half of the year?

**David Barry**

Yeah. Let me start with your Moen question, and then I'll let Nick talk big picture China and give some context to that.

Yes, we actually saw volume growth and price growth in Moen North America in the quarter, which is great to see. And as we mentioned in the prepared remarks, we saw growth in all channels in Moen North America. And given, you know, to your point, the single-family new construction ramp and the accelerated progress with Flo, we do expect their growth to continue across the second half of the year, which is nice to see.

Then I'll let Nick talk big picture China and then I can give some context there.

**Nicholas Fink**

Yeah and I'll just -- before jumping in just comment on a broader thing which I think is actually what you're picking up is really important. That growth in Moen North America and you had that growth in Outdoors. And so we were very pleased to see strong -- in this market, strong top line performance from these two key engines in our business in the key markets, right? I think that was a big take away from us, particularly, as you pull China out, you've got to see that very clearly like the cores doing really well.

In China, there were really two things at work one, just as a reminder, this time last year, there were a lot -- the government pushed to complete a lot of projects that have been sitting kind of in mid-completion mode. And so you had that lapse, but the Chinese consumer, and you've seen this across the industries and segments is very, very cautious. And I think there's some work to do, some Bank of China announcements this morning about interest rate easing. There is some work to do in that economy.

I think there comes a point at which it definitely does turn and becomes much more of an R&R focused market and then provides nice growth optionality. It also provides some very nice innovation for the broader portfolio just being that close to some very innovative consumer approach to the market. And so a nice pipeline there.

But the one headline that I leave you with before I just give it to Dave is that as this business has come down from its peak and the China housing market has come down from its peak, the team has done a fabulous job in managing profitability and managing the size and they've really resized and replatformed the business. It's gotten to the point now where I'd love for it to bottom out and provide some growth. Should it not, it actually isn't really that material anymore to the portfolio. I think in many ways kind of the worst is behind us just given its size now and its relative profitability of Fortune Brands it's just not a whole lot of impact to us.

### **David Barry**

Yeah, and then Phil, to put some context around that, I mean this was a \$500 million business in 2021. We now think it will be about \$250 million by the end of the year. So to Nick's point, a lot of this is behind us. It's taken a 50% reduction over the past three years. And if you look at -- relative to what we have going on in the rest of the portfolio, it's smaller than our digital and connected business. It's the House of Rohl business is more than twice as big. It's just a less impactful piece. And as it is replatformed and the market recovers, we do expect it to grow when we get to that point.

And then from a margin standpoint, it remains profitable in what was a high-teens operating margin business is now at the mid to high single-digits. And so the team is working to get cost out, but it's much smaller, much less meaningful to the overall portfolio and we have other avenues of growth going forward.

### **Philip Ng**

Okay. That's great perspective. And then, Dave, you were pretty confident that from an inflation standpoint for Water Innovation you're covered this year, but certainly, metal prices are higher, ocean freight ship and container prices are higher. So as you -- as we look out to 2025, you guys plan to take price, do you have some increases out there? And do you have enough levers still to drive margins higher? And then certainly with potential change in administration, there is talk to tariffs potential of horizon. Just kind of remind us how you're set up now perhaps versus '18, '19 in terms of your exposure to China? And how do you kind of anticipate combating that going forward?

### **Nicholas Fink**

I'll just make a quick comment on the pricing part, maybe philosophically on the supply chain part and Dave can break it out. Just philosophically on pricing, we've invested very heavily in category management capabilities that really allow us to understand better how to manage our categories as category leaders and where to meet the consumers. And those insights have led to a very different set of pricing discussions with customers where it really is about driving profitable growth for everybody in the category. And as constitute of that, we've really turned our businesses that we take price every year.

We may moderate how much or how little we take, but we are in an annual price taking cadence. I think it's very important to regularly exercise that muscle. Sometimes we may (inaudible) back, sometimes we may give a little bit here, but net-net, we're taking price and we will continue to do so and just do it consistently and do it in smallish increments where you're not shocking the market because you haven't done it in a long while and you get caught out, you just do it regularly and you do in a good cadence and you maintain a lot of predictability in the market and we feel very strongly about that. So with that, I'll let Dave dimensionalize it.

**David Barry**

Yes. And Phil, I think, Nick said it well, and we, you know, at this point, what we expect to see in 2025, we don't -- we expect to be able to cover it with both internal productivity and incremental price. And as Nick said, we look to take price every year just given our capabilities around category management, our brand strength, and our innovation.

But as we look across the back half of the year, given the length of our supply chains and our agreements with our suppliers, we expect to have an immaterial impact for many changes that occurred in the second quarter. And it's been nice to see, frankly, at the start of the third quarter, the metals have pulled back a bit. So if that continues, that will even ease the impact on 2025. Do you want to, Nick, tariff -- do you want to speak to tariff?

**Nicholas Fink**

Okay. Just very generally because I would say, look, I think that would be important to just dimensionalize a little bit how our supply chains change and it has changed quite a bit. But we don't invite it. It would be an immense amount of work as it's been in the past. I'll just remind you even going back to the days, we had tariffs, so there's been plywood tariffs, border tariffs, COVID shutdowns. Our supply chain team has excelled at outperforming the market. And while we don't invite these types of things that are enormous amounts of work, we tend to accelerate our share gain every time it happens.

And even quite recently in some very large customer discussions, our customers have demonstrated their supply chain team just even now how we are outperforming the general market in terms of our ability to deliver on time, in full, and be very consistent. And so I think we're certainly prepared and we're continuing to prepare ourselves no matter what the results of the election is. I think there's quite a likelihood that we may see some incremental tariffs. But we, with our firstly fairly heavy North American supply chain, I think, are very well equipped with the capability of the team, we'll probably come up even stronger.

**David Barry**

And if you look at the financials around it, Phil. So we today less than 20% of our spend -- our material spend is from China, which is down significantly from 2017 when it was north of 50%. So as Nick said, it's been well positioned. Team has done a lot of work. We haven't stopped doing the work because obviously, tariffs are still in place. And areas that are still in China, we have key components that are dual sourced. And while they might be at a higher cost if we move it relative to incremental tariffs, that equation tips in the favor of the new source. And so we feel well positioned and the team has worked hard to be prepared for what comes at us.

**Philip Ng**

Okay. That's great color, guys. Appreciate it.

**Operator**

The next question is from John Lovallo from UBS. Please go ahead.

**John Lovallo**

Hi, guys. Thank you for taking my questions as well. First one is maybe -- just maybe a little color on fiber on trends. I think you talked about up low single-digit POS led by wholesale. But I'm curious how that may have progressed through the quarter? And any color on what the exit rate was?

**David Barry**

John, I think that's pretty consistent through the quarter. So we didn't see much volatility as we would have expected given it's the season for deck building.

**John Lovallo**

Got it. Okay. And then if we just think bigger picture as we move out into next year, I mean, R&R has had a couple of years of being down. I know you don't have a crystal ball, but how are you kind of thinking about the kind of the slope of the recovery in repair and remodel spending as we move into next year?

**David Barry**

Yes. Looking at the usual factors that we consider when forecasting R&R, which for us is consumer confidence, unemployment, home equity levels, and then existing home sales. And so there's still a tale to be told here in the back half of the year as to how the consumer responds, getting through the election, understanding what level of interest rate cuts happen, if any, and then how existing home sales -- home sales respond. And so we'll continue to look at those factors and provide an update on our 2025 view when we get to that point.

**Nicholas Fink**

Just to add something, think about a fair amount as we think about the \$33 trillion of home equity. The home equity extraction rate is half of what it was in 2021. And I think that has been a factor of rates since we've just see less people go and tap their home equity to go and do things and I would suspect as rates start to come down and either the HELOC or refi markets start to open back up and that makes more sense for people and that delta might be less large between existing mortgage rates and what they could get. If we see that extraction rates start to even get back up towards its historical average, there would just be more cash available for people to do projects.

**John Lovallo**

Okay. Thanks, guys.

**Operator**

This concludes the question-and-answer session. Thank you for joining today's conference call. You may now disconnect.