Fortune Brands Innovations, Inc.
Second Quarter 2023 Earnings Conference Call
July 27, 2023

<u>Presenters</u>
Leigh Avsec, Vice President of Investor Relations and Corporate Affairs
Nicholas Fink, Chief Executive Officer
Dave Barry, Chief Financial Officer

<u>Q&A Participants</u>
Phil Ng – Jeffries
Stephen Kim – Evercore ISI
Michael Rehaut – JP Morgan
Susan Maklari – Goldman Sachs
Joe Ahlersmeyer – Deutsche Bank
John Lovallo – UBS

Operator
Hello. My name is Shamali (ph), and I will be your conference operator today. At this time, I would like to welcome everyone to the Fortune Brands Second Quarter 2023 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 and our web posting for additional information on our most recent acquisition, as well as our supplemental financials. The earnings release and our audio replay of this call can be found in the investor section of our fbin.com website.

I want to remind everyone that our 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 may be required by law. Any references to operating profit or margin, earnings per share, or free cash flow in 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
Thank you, Leigh, and thank you to everyone for joining us today. On this call, I will walk through the highlights of our second quarter performance and offer some thoughts on the macro environment. I will also discuss our recent acquisition and how we expect these leading brands to accelerate key strategic initiatives and contribute meaningfully to our performance. I'll then turn the call over to Dave for discussion of our financial results and how we're thinking about the remainder of 2023, including the upward revisions to our market forecasts and increase to our full-year 2023 sales and EPS guidance.

Turning to our second quarter performance. Our results and the actions we took this quarter demonstrate the resilience and strength of Fortune Brands Innovations. Our teams delivered solid sales and strong margin results amidst an external environment that remains dynamic. Our leading brands are focused on meaningful innovation and our advantage channel relationships positioned us well in the current environment and drove our results. I want to thank all of our associates for your dedication and pursuit of excellence, and again, welcome our newest associates to Fortune Brands innovations. Together, we are going to continue to build an exceptional company.

Net sales of $1.2 billion in the quarter were down 7% versus the prior year, and our operating margin was 17%. Our top line results were 50 basis points above our estimates for our market. These results demonstrate our ability to grow above the market, protect margins, and invest in key strategic growth initiatives, even in a challenging environment. Our sales and margin performance generated earnings per share of $1.07. As we discussed in our last earnings call, heading into the second quarter, we knew that we were coming up against uniquely challenging year-over-year comparisons.

As we expected, we saw sequential point of sale dollar growth versus the first quarter of 2023. It was not at the same exceptional levels of ramp up that we experienced in 2022. As a reminder, the slowdown in the market for our products and major inventory destocking began in the second half of 2022. In fact, our second quarter 2023 organic sales results were 19% higher than in the second quarter of 2019, demonstrating that consumers continue to be interested in investing in their homes.

Our results this quarter reflect our unwavering focus on our growing the market, preserving margins and generating cash, all while continuing to prioritize key investments, including brand building, thoughtful capacity additions, meaningful innovation, and our digital transformation. I believe that we are very well positioned as we head into the second half of 2023.

Turning now to some thoughts on the current U.S. housing market and the market for our products. As we've consistently stated, demand outstrips supply in the U.S. for housing, which creates a market opportunity for our products in both new construction and repair and remodel. There is significant pent up housing demand, driven by several factors that I'll touch on shortly. This demand, together with our strong and optimally positioned brands, will result in medium to long term tailwinds for our business in both new construction and repair and remodel.

Starting with new construction. As has been widely reported, the new home construction market has fared better than anticipated despite higher interest rates. Existing home inventories remain near historic lows, as U.S. housing remains severely underbuilt. Builders, particularly the large production builders with whom Fortune Brands enjoy strong relationships, have been responding to affordability challenges in the dynamic marketplace by building SPEC inventory, and providing sales incentives, including rate buy downs.

Sales of new homes have been increasing throughout the year and starts our game outpacing completions. The backlog of new homes is also increasing, albeit at at a much more manageable rate. With that as a backdrop, we revised our single family new construction outlook upward for the remainder of the year are continuing to monitor for economic volatility and the potential for full recession.

Turning to R&R. Within the broader repair in remodel space, we remain confident that our products are uniquely and optimally positioned to outperform. Several factors are converging to result in the unique opportunity for growth. First, the current lack of existing inventory combined with the fact that over 80% of mortgages are under 5%, means that people are more inclined to stay in place and make the home they have into the home they want. Next, consumers continue to have high confidence in their homes as an asset, given the extremely high levels of home equity and personal real estate investments, which have offered financial stability and strong rates of return.

Finally, the average home is over 40 years old, and homes built during the early 2000's boom are coming into prime R&R. Additionally, the baby boomer generation continues to prefer aging in place and investing in their homes, while millennials and other first time homebuyers are purchasing homes in need of upgrades due to limited available inventory, and affordability concerns. These demographic trends are all supportive of repair and remodel.

Our data shows that our products are less tied to existing home sales, and instead are more dependent on factors like consumer confidence, age of the house, and home equity and employment levels. We believe our products are relatively more insulated than other R&R items, because they are smaller ticket items, are less disruptive to install, and because they offer immediate aesthetic improvement, or meaningful innovation and functionality to a home. In short, people buy our products because they want to enjoy them. That said, we are aware of the uncertainty inherent in the broader macro environment. And we are watching market conditions closely, and we will respond quickly if warranted.

Turning now to our most recent acquisition. I'm extremely excited about the recent acquisition of two world-class businesses from ASSA ABLOY, the Emtek and Schaub premium and luxury door and hardware business and the U.S. and Canadian Yale and August residential smart lock business. Dave will provide more color into the numbers, but at a high level, we expect second half 2033 sales for these businesses to be approximately $190 million to $210 million, and for this deal to be accretive to our P&L in 2023 with $0.04 to $0.06 of EPS, even after factoring in $0.08 of purchase price amortization. This acquisition is a great example by disciplined approach to M&A.

Emtek and Schaub are the market leading brands in the luxury hardware space and will be a fantastic complement to our house overall business. The margins for these brands are exceptional, and we look forward to leveraging the team's demonstrated skill driving phenomenal customer service and highly designed products while also maintaining high margins across the entire Fortune Brands portfolio.

Including Emtek and Schaub, our luxury platform will now be over half a billion dollars in annual sales and the potential synergies are meaningful. This acquisition will allow us to expand our presence luxury showrooms further penetrate the luxury hospitality market, and become an authentic global luxury design house, offering cohesive product offerings and finishes throughout the home. Our consumer remains strong and is increasingly interested in products with story brands and distinctive quality, and we believe our growing luxury portfolio speaks to the secular demand trend.

The Yale and August residential smart security businesses consist of innovative brands with a strong IP portfolio, and exceptional digital talent. As part of the acquisition, we've added roughly 100 new engineers supporting in-house software and hardware platforms, who will leverage across our portfolio of brands over time. In addition, this acquisition will allow us to expand our retail and omni channel and wholesale door lock business, broaden our residential connected security ecosystem and accelerate innovation across our brands, including the potentially transformative development of a fully integrated smart entry door system. Here, again, the potential for synergies is significant.

This acquisition will be a key accelerant to our growth strategy. It allows us to expand an existing channels and categories, as well as a new, high growth spaces with secular tailwinds. Importantly, through the addition of Yale and August, this acquisition is a key step in our transformation into a digital, innovative disrupter. Further, with the addition of Emtek and Schaub, we will materially accelerate our strategy to build the House of Rohl into a global luxury powerhouse for the entire home. Combined with our existing Fortune Brands business, we now have the knowledge base, the growth platforms, and the brands to bring new and disruptive products and services to the market that will be the first of their kind.

Overall, Fortune Brands Innovations is well positioned for both the near-term and the long-term. Our branding power, meaningful and value add innovation, and strength in the multi-step distribution channel are powerful moats in uncertain times and accelerants in times of broader economic growth. Our recent acquisition of the leading Emtek, Schaub, August and Yale brands will provide growth opportunities, and nicely complement our strategic focus on branding, innovation, and channel. Our brands are uniquely positioned to outperform the market in all environments, and our newly aligned structure, together with our Fortune Brands advantage capabilities, will enable this outperformance, as our results demonstrated this past quarter.

As we announced in the release this afternoon, we are raising our full-year sales and free cash flow guidance and again, raising our full year EPS guidance. Dave will give more details, but this increase reflects our confidence in the Fortune Brands business. Before I turn to the individual business's performance, I would like to remind everyone that our second quarter 2023 results reflect both the impact of challenging prior year comparisons, plus the impact of the single family new construction market, which slowed abruptly in the second half of 2022. That slowdown is now being digested through our business.

In the second quarter, water innovation sales declined 5% compared to the prior year quarter due to market driven volume declines across the segment partially offset by price. Our margins for the segment were 23.2%. (inaudible) U.S. business has strong, long-standing relationships with the top U.S. production builders and our strategic decision to invest in our relationships with these key customers yielded tangible results.

In retail, we saw more general market softness as the DIY consumer market slowed. Our house of roll brands total sales were up low teens for the quarter, including Aqualisa, and down high single digits organically, reflecting the impact of high second quarter 2022 comps and a softer market. For the full-year, we expect our organic sales to be flat as our story of craftsmanship and unique designs continues to resonate with the luxury consumer who is increasingly seeking differentiated goods and values timeless quality.

We recently announced the building of a new facility in the UK, which will help meet global capacity needs of the business as we continue to expect our brands to perform well. In China, sales were up over 30% year-over-year. This reflects the impact of lapping the second quarter of 2022, which was marked by the Shanghai COVID shutdown. We also saw higher than expected project completions, although the overall market remains soft in the Chinese consumer remains cautious. However, we continue to capitalize on our leadership positions and are well positioned within the Chinese housing market, where we are increasingly focused on the emerging Chinese R&R market. For the full year, we now expect China sales to be down high single digits.

In outdoors, sales declined 14%, reflecting expected market softness, which was partially offset by price. We saw sales improvements sequentially throughout the quarter and are encouraged by July results so far. We are pleased with our operating margin of 16.4%, which is 80 basis points higher than our second quarter 2022 results and is a proof point of the success of our newly aligned operating model. We are well positioned across our outdoors brands to respond to any changes in demand patterns and are making investments to continue to best serve all of our customers and channel partners, while also focusing on the innovations which we believe will further differentiate our products.

In decking, POS trends indicate continued strong consumer interest in this category, and the recent reacceleration of sales, as the value proposition is increasingly understood by consumers and pros alike. Wholesale sell out improved throughout the quarter, and we exited June up high single digits. In the quarter, sales were down high teens versus the same quarter of 2022. However, when comparing to Q1 of 2023, we saw sequential sales increased by more than 50%. Our channel partners were conservative with inventory buys in the beginning of the quarter, but in June and into July, have been accelerating their inventory purchases and our POS data shows that we are growing above the market.

Indoors, sales declined low teens as the slowdown from the 2022 single-family new construction market impacted Therma-Tru. We are confident in the long-term opportunity, as well as in the strength of our product offerings, and our long-standing advantage relationships with our key customers and channel partners, as we look to maintain and grow market share in the most attractive parts of the market, including in the single family new construction market.

Lastly, in security, sales increased 2% over the prior year quarter. These results were driven by price and continued growth in commercial and international markets. As we have previously mentioned, our security and water businesses share many key similarities, including the importance of their iconic brands, with consumers and trade partners a strategic focus on connected products and the structure of their operations and supply chains. The security business continues to implement the Fortune Brands advantage playbook that we first used to transform our water business eight years ago, and the results of becoming apparent. Going forward, the team will work to continue to evolve this business into a higher growth, higher margin business, focused on driving the power of our brands and developing meaningful innovation.

Before I turn the call to Dave, let me share a few final thoughts. We took meaningful steps this past quarter to prepare Fortune Brands for continued growth. Our reorganization into a more efficient, centralized company, focusing on brands innovation and channel has progressed more quickly than we anticipated, thanks to the strong engagement from our teams, and the impact was apparent in our results. We made important changes to our supply chain to align with our growth areas and margin progression targets. We continue to invest in our key strategic priorities, including our iconic brands, digital transformation, and meaningful innovation. And finally, we closed on an exciting, potentially transformative acquisition that we expect to drive growth and accelerate our larger strategy.

As we highlighted last year, the actions we took in 2022 were designed to transform Fortune Brands into a growth-focused, highly innovative company. Six months following our separation, I am encouraged by all that we've accomplished and excited about what we will achieve next. As reflected in our revised full year guidance, we see some positive indicators of a healthy consumer will also be mindful of potential short term disruptions. We are constantly monitoring and are well prepared to respond to uncertain markets in the short-term, while we position ourselves for accelerating longer term outperformance in a market supported by fundamental growth characteristics. As we head into the second half of 2023, we are focused on execution and delivering on our commitment to above market sales growth and margins.

With that, I'll turn the call over to Dave.

Dave Barry

Thanks, Nick. As a reminder, my comments will focus on... 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 executed well this quarter amid challenging comparables and the impact of last year's abrupt slowdown in single-family new construction.

Our results reflected their dedication. Sales were 1.2 billion down 7% and consolidated operating income was $198 million down 11%. Total company operating margin was 17% and earnings per share were $1.07. Our sales in the second quarter largely tracked our POS. Volume was down high single digits, which was partially offset by low single digit price. Changes in channel inventories did not impact consolidated results. As we discussed previously, we expected operating margin in the first half of 2023 to be heavily impacted by production inefficiencies and stranded fixed costs related to our inventory reduction efforts.

We continue to make excellent progress against our near-term inventory reduction target, and our organic second quarter inventory finished at $845 million, down roughly $240 million from our third quarter 2022 Peak. Our second quarter operating margin of 17% included a roughly $20 million impact from these efforts, bringing the total P&L impact in the first half to more than $50 million. Going forward, healthier supply chains and our more aligned organizational structure should improve our ability to accurately forecast with continued focus on service levels and inventory mix.

While we are pleased with our second quarter results, our teams remain focused on driving out performance, including above market growth, preserving and enhancing margins and generating cash. Our continued focus on these performance metrics has enabled the team to drive both key strategic growth investments and strong cash flow. As I will detail later, our balance sheet remains strong, and we have the flexibility to manage through various economic outcomes while deploying additional capital to drive shareholder value.

Now, let me provide more color on our segment results. Beginning with water innovations, sales were $617 million, down 5% and down 6% excluding the impact of the Aqualisa acquisition and FX. The net sales results reflect the impact of lower volumes partially offset by price. Water innovations operating income was 143 million and operating margin was 23.2%, reflecting lower volumes, partially offset by price and continuous improvement initiatives.

Our point of sale performance for Moen was down low double digits and in line with our expectations given the challenging comparable period and prior year slowdown in single-family new construction. Houses of roll total sales were up low teens, while organic sales, excluding our Aqualisa acquisition, were down high single digits, primarily due to strong prior year comparables and market softness, which was most pronounced outside the United States.

China sales grew more than 30%, primarily due to an easy comparable following the prior year's COVID shutdown that acutely impacted the Shanghai region. The Chinese market remains soft, and though the completion of delayed projects is accelerating. New home sales and starts are moderating as the Chinese consumer remains cautious. That said, we continue to see growth in the emerging R&R channels and our position for market outperformance due to the strength of our brands and expertise of our in country leadership.

Turning to outdoors, sales were $376 million, down 14%. Segment operating income was $61.6 million down 10%. Importantly, our margins improved both versus the prior year and sequentially to 16.4% driven by volume leverage, price and plant productivity. Door sales were down low teens. As expected, sales were impacted by lower volumes from the single-family new construction slowdown in 2022 and the challenging POS comparables. However, our wholesale business is performing above market and the business should be positively impacted by the improved new construction outlook.

In decking, as Nick mentioned, we saw POS accelerate through the quarter and continue to expect full year sales to be roughly flat to prior year. Finally, in security, sales increased 2%, reflecting increased distribution, price and continued strength in commercial and International security. Security segment operating income was $27 million, up 6% versus 2022. Segment operating margin was 15.6%, up 70 basis points. Our team continues to work to transform our security business into a higher growth, higher margin business focused on attractive categories, where our brands and innovations can drive consumer and customer share gains over time. This strategy will be accelerated by the integration of the Yale and August assets.

Turning to the balance sheet and our cash flow performance. Our balance sheet remains strong with cash of $682 million, net debt of $2.6 billion and net debt to EBITDA leverage at 2.9 times. This leverage ratio reflects the impact of a recent acquisition. And we expect to reduce our net leverage ratio over time as the business continues to generate strong cash flow. We generated free cash flow of $358 million in the quarter, bringing our first half free cash generation to $391 million. Our working capital reduction efforts continue to shrink our balance sheet and generate cash.

To summarize the quarter, we delivered solid sales and strong margin results in a fluid environment, while overcoming the most challenging period of prior year comparables and the impact of the slowdown in single-family new construction market in 2022. With that in mind, I'll now provide an update to our 2023 guidance, inclusive of the acquisition of the ASSA ABLOY assets.

As indicated in our release, and in our supplemental presentation, for the second half of 2023, The acquisition is expected to generate net sales of $190 million to $210 million in earnings per share of $0.04 to $0.06 cents. This includes the unfavorable impact of approximately $0.08 from purchase price amortization. Based on revised market assumptions, which include an improved outlook for U.S. single-family new construction, plus the impact of the ASSA acquisition, we now expect full year consolidated fortune brand sales to be flat to down 2%, or down 4% to 6% on an organic basis. We now expect full year operating margins between 16% and 16.5 %, reflecting the impact of purchase price amortization from the acquisition. On an organic basis, we continue to expect operating margin to be around 16.5%.

As today's press release, and our supplemental web posting indicated, we are increasing the midpoint of our EPS guidance by $0.08, and narrowing the overall range to $3.75 to $3.90, reflecting the acquisition and our organic business's performance in an improving market. As a reminder, we previously raised or EPS guidance during our first quarter 2023 earnings call reflecting our operational out performance. So in total, our updated EPS guidance reflect a $0.13 increase over the midpoint of our initial guidance.

In closing, as we head into the second half of 2023, we remain ahead of or tracking to the guidance targets we put forth at the beginning of this year. We have delivered solid sales results, managed our margins and made significant improvements in cash generation. Our teams have done a fantastic job navigating the uncertainty of the past few years. And as we come into the back half of 2023, we remain confident about the future of the business.

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 over to the operator to begin the question and answer session. Operator, can you open the line for questions? Thank you.

Operator
Thank you. Again, we will now be taking a limited number of questions. And since there may be a number of you who would like to ask a question, I ask that you limit your initial questions to two and then reenter the queue to ask additional questions. 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 lines in the question queue. You may press star, two, if you would like to remove your question from the queue. And for participants using

speaker equipment, it may be necessary to pick up your handset before pressing the star keys. Again, that's star, one, to register a question at this time.

Our first question comes from the line of Phil Ng with Jefferies. Please proceed with your question.

Phil Ng
Hey, guys. Appreciate the great investor deck. It's got some good insights on the ASSA deal. Looks like you're anticipating pretty strong growth, with sales stepping up from $400 million to $525 million in 2026. Can you provide some color on the growth drivers? And Nick, I think you don't typically do too much cross-selling in past deals. What's giving you the confidence on the cross-selling synergies you're calling out? I think it's about $65 million to $85 million. How do you see that kind of wrapping up? And what are some of the big opportunities?

Nicholas Fink
Hi, Phil. Thanks for the question, happy to elaborate a little bit. We obviously seen a variety of deals done a variety of deals over time. This one really sets at a wonderful crossroads of being fantastic brands backed by an excellent team, a great price paid through some really disciplined approach to the asset itself. But then thirdly, the third part of the intersection is really the opportunity to come and unlock growth by putting these things together in our portfolio. And we try to be really disciplined about run value, but then also really just blend around on the other two items, which is looking for great brands and teams. But asking where we can add value with a Fortune Brands portfolio. And I'd say this is one of the more exceptional deals that we've seen.

And so I'll give you a couple kind of key foundational pillars, and then happy to elaborate if it's helpful, but one, I'd just started actually with the Emtek business. So Emtek and Schaub, leader in the luxury hardware category, very design-led, a lot of colors and choices for designers, incredible supply chain and service, really, a concierge approach. And doing that at really, really fantastic margins, not something that you see very often, bring all of those things together.

And we look at the house of roll platform, which you can see in the organic results here continues to take share and outperform the market and is really, really resonating with consumers and designers. By putting those two things together over time, we'll now have a platform that's north of half a billion dollars, outgrowing the market and has global reach, right? And the elements really work together, whether it be in the channel where we have overlap in types of distribution channels, but not necessarily overlap in all of our distribution. But then even things like being able to unlock collections for an entire route, do color matching, do design work together, and really provide a solution where designer consumer gets to put something together the way they want it, but in a way that works with our backing as a company.

And so that's an example, and then I think you go over to the other side, Yale and August, really driving tech first and connect with product first. And the August platform itself as we're getting in there and learning more about it, we think is a very, very powerful platform. That is something that we can bring in a business, by the way, learn from what they've done, and be really thoughtful about how we integrate it. But we see it as a huge unlock, and potentially a transformational unlock in our connected products business generally, right, the ability to bring that many engineers, that skill set, that kind of agile and fast way of working into the investments we've already made, which we're really happy with, but we think it can be exponentially greater when you bring those two things together.

And one of the things that we call that in the deck, for example, is smart entry. Right? We're going to have one of the leading entry lock businesses and brands, with some of the best if not the best technology, and you marry that with the leading fiberglass entry door brand, already a leader in a space, right, and think about all the innovation that went into that. And you actually make that thing work not as just a bolt on to an existing system, but a total system solution for consumers. That's just an example of the kinds of things we're thinking about. And so the team has been getting off to this one really enthusiastic.

We have a number of deals. I'm not sure (inaudible) business team sort of jump on synergies the way this team's jumped on them and with the level of excitement and really kind of pushing up beyond our initial case, which we thought was pretty good to begin with. And so you bring all those things together, we just think it's really excited this quality of brands, this team, coming into your entire portfolio with this potential transformational unlock, and to have been able to do it at this valuation.

Phil Ng
That's super. That's great color, Nick. Glad to see you're really excited about this transaction. You bumped your organic sales guide. Give us some color on any intercooler, intracore (ph) trends you saw earlier read into July. You've expressed a more upbeat outlook on new construction. How do you see that inflection in the orders to build or so called out in your business, particularly plumbing and doors? Thank you.

Nicholas Fink
Yeah. So I'll start and then I'll hand it over David, who can give a bit more detail about it. But I'd say at the highest level, if you think about it, it's actually been fairly consistent somatically with what we saw in the second quarter. And so what is it you saw? Relative strength in both builders, I think relative to expectations, in their order books and what was being reported. Now, obviously, in Q2 of '23, we're digesting a slowdown from last summer, right? And so the uptick is yet to come through the P&L.

And then on our R&R our side, I'd say relative strength in everything that was more project or pro related and relative weakness in things that were more kind of DIY, or weekend warrior related. And as you've been looking to July, I'd say thematically, that continues to be true, and we're going see more uptick around the large production builders. We're seeing their value chain supply chain start to strengthen as people prepare for those orders to come through. We've seen continued strength in our pro related channels were, I think, projects continue to be strong. And it's more around the very discretionary DIY products that you continue to see some weakness. But as Dave alluded to in his remarks, even there, in the last few weeks, there's some encouraging signs of certain product groups where you're seeing at retail, a little bit more life than we've seen in that DIY stuff.

So Dave, I don't know if you want to add?

Dave Barry
Yeah. So I'd add some color around just the second half sales cadence. And so if our prior organic guidance was down 3% to 5%, remind people that includes the extra non-repeating fiscal week from last year, that for the second half is roughly two percentage points, all in the fourth quarter, or four percentage points overall. So that organic guidance, then call it down two percentage points, excluding that comp, removing it the midpoint of our current guidance now to a flat in the second half of the year. And I think simply, you think about it, it's POS down low single digits, offset by a favorable inventory comp of low

single digits. That gets you roughly to the flat, and then the non-repeating fiscal week is a two percentage point headwind, and that gets you to the midpoint of the guidance.

So to Nick's point, here at the end of July, we look at our POS data, we see it trending in the right direction to support this forecast. And then the layer on top of that, the single-family new construction improvement that will really start to benefit us in the fourth quarter, that gives us confidence to believe in our second half outlook.

Phil Ng
Okay. Really appreciate the color, guys.

Nicholas Fink
Sure. Thank you.

Operator
Our next question comes from the line of Steven Kim with Evercore ISI please proceed with your question.

Stephen Kim
Yeah. Thanks very much, guys, appreciate it. Yeah, a lot to ask about. Let's start with the acquisition. I think that you had indicated that there was going to be a little purchase accounting impact in the back half. Any reason why we should expect that to continue into fiscal '24? And if you look across the the sales synergies and cost synergies, do you think we could see some of the cost synergies by the end of the year start to trickle in? Just give us a little color on, I guess, timing in 3Q, 4Q and maybe a look into 1Q?

Dave Barry
Steve, this is Dave. I'll talk to that. On the synergies side, I think maybe some of the sales synergies trickling in by the end of the year on the cost side because of their inventory positions, while the teams will be doing the work. We won't see that in our P&L until next year, just given the balance sheet. And then to your question on purchase price amortization. So remember, these are trade names that are amortized over a long period of time. So it is roughly $0.08 in the back half of this year. It'll be $0.16 in a full year next year impact and then going forward beyond that, pretty consistent for the next 10 or so years until that trade name is fully amortized and off the balance sheet. So hopefully that helps to answer your question. Nick, if there's anything you'd add?

Nicholas Fink
Nope.

Stephen Kim
Okay. Great. That's very helpful. Now, I know that your guide, you mentioned your guide, the improvement sort of reflects to some degree, and I think a large degree, an enhanced view of single-family activity, and I'm assuming there's basically the lag starts effect. Are there any mix or margin implications from the rebound that we've been seeing in housing starts start to emerge as well? If you could talk to that, that would be helpful.

Nicholas Fink
So the mix impact on us?

Stephen Kim
Yes, benefit to you. You talked about the top line, but I'm wondering if there might be margin implications that would come from that. And if you could describe what those might be?

Nicholas Fink
Yes. I'll just give you some thoughts around it thematically, and Dave can give more color. I would say, bottom line is we are, and we really work to keep the portfolio market agnostic, whether it be around product price point of their margin percentage, around product price point or around channel. And so if you look, you think about it, we might have--if we see a lot more production builder business, that may come in at a lower contribution margin, for example, but it takes a lot less to serve that business, because they're big customers. You can call on them. It's more standardized and say, you know, shorter business, which you need big sales forces out in the market serving that maybe higher contribution margin, the larger SG&A supporting it, and at the end of the day, that sort of balances out.

And so it moves around the P&L, is that P&L geography, but I would think about it as we're fairly agnostic no matter kind of the channel or where we sort of set price points in that continuum from premium to ultra-luxury in our portfolio.

Dave Barry
Yeah. And I would just add, and Steve, I pointed to our our full year guidance sort of operating margins for water, which prior was 23% to 24%. And updated is around 23.5%, so at that midpoint, inclusive of the change in single-family, new construction and the headwind from the purchase price amortization from the ASSA deal is now rolling into that segment. So pretty consistent from a margin standpoint within water.

Stephen Kim
All right. That's very helpful. Thanks, guys.

Operator
Our next question comes from the line of Michael Rehaut with JP Morgan. Please proceed with your--

Michael Rehaut
Thanks. Good afternoon, everyone. First, I just wanted to dial in a little bit on some of the puts and takes on the updated margin guidance for the year. I guess, on a segment level, you had security, Nick, down at the high end of the prior guidance, and just wanted to confirm that that's, I assume, largely just driven by the acquisition accounting. And if there were any other puts and takes into the back half outlook. Particularly, I'm thinking about to the extent that you have a little bit better top line outlook, organically at least. Were there any additional leverage that you were thinking of? And was that offset by anything else? And then I just had a follow up.

Dave Barry
Yep. Mike, this is Dave. On the security question, you are correct. That's predominantly just impact from accounting from the acquisition, and the base business is performing well, as evidenced by their margin results in the second quarter. And then in the back half, we had said on our initial call this year, that we expected back half operating margin to be between 17% and 18%. We still think that's the right range for the back half, between 17% and 18%. Now, there are some puts and takes in there. We are making some

incremental investment, investing in digital, investing in brand in R&D in the second half. We're controlling that tightly, but we see some areas that we want to accelerate as we head into 2024.

And then interestingly, if you look at our first half margin performance of 15.2% and normalize for the inventory reduction overhead of $50 million that we called out, you're right about 17.5%. So it's the business is demonstrating pretty consistent margin performance and trajectory, while digesting some of the implications of reducing our balance sheet in the market volatility but we feel good about the outlook going forward.

Nicholas Fink
I'll just add, Mike, if you think back to our investor day, in December when we presented that longer term margin walk and all the activities that we had planned to start to drive those, feeling very good that that is now coming through in both the security and the outdoors business. And notwithstanding the fact that it was a pretty choppy, external environment out there. You can see the businesses making the progression that we want them to make. And we're doing that by taking this newly aligned structure, and the Fortune Brands advantage playbook and applying it, and the teams are feeling very good about their ability to execute well against that over time.

Michael Rehaut
Right. I appreciate that. And I guess, secondly, maybe just go back to the slide on the deck around the synergy opportunities on the top line, which very detailed, and obviously, very well thought out. I think back to the acquisition of Fiberon. And I believe you had, correct me if I'm wrong, I want to say a 50% growth over three years. And a lot of that, due to some really nice additions on the distribution side. You were able to secure new customers, etcetera, added distribution for the Fiberon product. We see a lot of expansion of channel in both the Yale and August and Emtek and Schaub. And so I guess the question is maybe just to push--obviously, these are really good numbers in terms of the synergies on the sales side, but I would have actually thought perhaps there would have been room for slightly higher numbers. And maybe I'm just being a little too aggressive, or maybe you're perhaps being conservative, just wanted your take on that. Particularly over a three year period, it does seem like there's a lot of cross selling opportunities to the point on the slide, and just curious if I'm thinking about things maybe a little too aggressively in terms of even greater upside potential.

Nicholas Fink
Yeah. Well, firstly, I'd say, thanks for calling up the Fiberon analogy, because I think it's really good. And I think what's particularly interesting about that example, that you call that is, that is still ongoing. Those gains at a higher margin part of that business and those distribution gains are still unfolding. Obviously, the markets are a little bit tougher this year, but as we just check that conversion rate, so that bounces between 1% to 2%, you see it sort of move back up, you'll see those play through. And during that whole time, though, we're preparing a business to then build on, right, brand and innovation and so very thematically, I think.

So what I'd say, specific to August, Emtek and Schaub is, firstly, just call out, we closed June 30th. So we've only had the teams together for a short amount of time, and they've identified a series of synergies that we put here, particularly around channel and what we'll do is we'll be very respectful of what these businesses do better than the legacy Fortune Brands Innovations business, and so they have channel strength in certain areas that is better. And we will look to learn from that and build it into the legacy business. And then conversely, there are, of course, places where, the legacy business has a strength that these businesses don't where we construct to expand through distribution, and access and channel strengthen relationships.

And so will there be more upside over time for that? Possibly, but I think the real big unlock comes from really, sort of the one plus one equals five strategy, which is as you put these things together, can we unlock new innovation, new approach, whether it be on the luxury side, where we really are going to have a lot more scale, to go off to the business on a global basis with that luxury consumer, who cares about brand and cares about the artisanal stories behind it, or on the technology enabled side, where our connected business is going to be that much bigger and the infrastructure backbone, on which it now all six is going to allow us to unlock innovation at a faster pace. And I think that's where the real upside may exist, but that it's going to take us a little time to work through those innovation opportunities and bring them to market.

Operator
Our next question comes from the line of Susan Maklari with Goldman Sachs. Please proceed with your question.

Susan Maklari
Thank you. Good afternoon, and thanks for taking the questions.

Nicholas Fink
Sure.

Susan Maklari
Can you talk a little bit about how your positioned from an inventory perspective across the different channels and the different segments? Sounds like you got a nice lift in the quarter from the volumes that did blow through there. If you think about the back half, what's the ability to capture any further upside to demand and perhaps see those volumes continue to move a bit further?

Dave Barry
Yeah. It's Dave. I'd say, looking at water and security, relatively balanced from an inventory perspective relative to the rate of sales. Like I said, we're still a little bit light in outdoors in the channel, primarily around wholesale decking at the end of the quarter. And we do expect and really have started to see some of those orders that we expected come through in July for decking. And so we're seeing that inventory fill back up. But I think if the market were to accelerate beyond our expectations, in the second half, there would be some inventory upside opportunities, as we would expect customers to put some inventory ahead of those sales. But where we sit right now, it's pretty well balanced, and we've kind of gotten through a lot of the prior year challenges from inventory builds and depletes that were really noisy on the sales line.

Susan Maklari
Okay. That's helpful. And then, you talked about security, and some of the company's specific efforts that are going on there to drive results just sort of above and beyond the acquisitions that closed this quarter. Can you just talk a bit more about some of those initiatives? And how should we be thinking about them

flowing through to the business and actually coming through in terms of both the revenue and the margins over time?

Nicholas Fink
Yeah, a very simple way to think about it is if you just rewind the clock a little bit on the water business, and you just observe what sort of happened, I'd say, starting in '15, '16, in the playbook that was applied there. It's the same playbook being applied to security. And actually, they're very similar in sort of brand resonance, ability to put innovation behind it, connected product, and even the supply chain has a lot of commonality. And so you can really sort of almost lift and shift a lot of that playbook. So starting from the top line down, far more emphasis on innovation. And so what we're seeing come through, we alluded to strengthen commercial, we're really developing a leadership position in some of the safety work that we do.

In facilities, it's very sticky work. We go in and do consultative selling. We help make facilities safer. There's obviously a lot of emphasis on that right now. It's a great strength of ours. We're able to put the brand and innovation behind it. Eventually that will be connected, as well, and will be a much more data driven thing. And that's just an example of a vector that can drive top line. And then you sort of play it through like the supply chain improvements that we made in water, whether it be in sourcing, or footprint over time, allowed us to generate a lot of fuel that we then reinvested to drop the top line, some of which came into margin. And you saw the margin progress over the years, but a lot of which was invested in the top line. And so it really is those sorts of capabilities, but we talked about the Fortune Brands advantage capabilities, because it's taking that playbook, applying it, and I think over time, and particularly as we bring these assets, these new assets into play, and are able to accelerate some of the connected overlap, we'll not just see the top line accelerate, but we'll see the margins go along with that.

And in our philosophy, that's very much a virtuous cycle, because as you develop those margins, you're able to invest in these businesses faster. As you invest in them, obviously, the top line grows even quicker.

Dave Barry
And Sue, just put some numbers behind that we are starting to see it come through the results. And so if you look at security's performance versus the second quarter of 2019, sales are up 15% or roughly a 4% CAGR, and their operating margin is up 390 basis points. And so you see the output of what Nick described is really taking that playbook from water, embedding in its security and getting that flywheel going around growth reinvestment in margin enhancement.

Susan Maklari
Yes. Okay. Great. Thank you for the color and good luck.

Nicholas Fink
Thank you.

Operator
Our next question comes from the line of Joe Ahlersmeyer with Deutsche Bank. Please proceed with your question.

Joe Ahlersmeyer
Yeah. Thanks very much. Good evening, everybody.

Nicholas Fink
Hi, Joe.

Joe Ahlersmeyer
Just want to go into the Yale business a little bit deeper. If you could maybe quantify the amount of the business that's currently going through ecommerce, any considerations there around key customer partnerships with a change of control, anything to consider there?

Nicholas Fink
Yeah. I'll give you some perspective as broadly and Dave can elaborate, although, we usually don't break it down to that level of granularity, put some information in the deck here. But I would think that this business has has historic strength in integrator channel, which we found very interesting. And so as people connect to products into homes, there's the one at a time which August is built on, but there's also a multiple, and it's worked on the system with an integrator. And what's really interesting about the Yale infrastructure backbone is how flexible it is on a variety of different systems. And so that's a real strength of theirs, something that we don't have elsewhere in the business and so we really want to build upon it, we could expand our portfolio, even in our existing (inaudible) like business and portable security business.

I think there, we're able to secure things that are portable in a connected way, and so if we can leverage that backbone. And then of course, we have a lot of strength in retail and ecommerce, which historically has been, I'd say, weaker for Yale. And so we think that's an opportunity where we can leverage our historic strength to build their business up.

Dave Barry
Yeah. And Joe, I'd say, interestingly, like our connected product business, this business has been chip constrained, and they actually prioritize these third party integrators over other channels over the past few years. So the amount of sales flowing through ecommerce or even brick and mortar retailers are lower than the demand would be for this type of products. As we get this business integrated back in stock, that'll be another growth avenue for us going forward.

Joe Ahlersmeyer
Yeah. And that was actually my second question, was around those constraints you had mentioned earlier, I guess, late last year. So maybe, for my second question, I'll just ask a clarifying question on the wholesale decking. Did you say that sell out improved high single digits, and was that versus for a specific amount of time?

Dave Barry
Yeah. We said at the end of July, we were going to hit single digits versus prior year, sell out.

Joe Ahlersmeyer
Like a trailing four weeks or something? What's the period?

Dave Barry
Yeah, yeah. That's how we look at it.

Joe Ahlersmeyer
All right. Great. Thanks a lot, guys.

Nicholas Fink
For sure.

Dave Barry
Thank you.

Operator
And our next question comes from the line with John Lovallo with UBS. Please proceed.

John Lovallo
Hey, guys. Thank you for taking my question. I guess, first question would be on water volume in the U.S. I mean, can you just help us with what that was down in the second quarter? And maybe what the positive impact from pricing was? And then more broadly, where are you seeing potential opportunities for incremental pricing across your broader portfolio, as we move into the back half of the year?

Dave Barry
Yeah. I'll start and then Nick can comment. Just decomposed water sales, reported sales down 5%. Strong sales growth from China, given the prior year comp and the acceleration of some previously started development. So if you pull that out, organic, excluding China be down about 9%. We see POS down low double digit. And so within that, and John, its volume, down low double digits offset by price up, low single, which is consistent with what we've been saying all along. We took a low single digit price increase in water at the beginning of the year, and that stuck and remains in market.

And then there's a small, low single digit benefit on sales from product load and timing around Amazon Prime Day, which was just different weeks last year versus this year, and it fell into the second quarter. But the cleanest way to think about it is POS down low double digits, volume down low double offset by most single price.

Nicholas Fink
And then the second part of your question on pricing opportunity, what I'd say is part of these Fortune Brands is about just capabilities. I was just talking about, one of the things that we've invested in is category management skills and capabilities, particularly in water insecurity and now, carrying them over to the outdoors business. And what that does is really give us the ability to understand what is happening with the consumer, what is happening with a pro at the shelf, using data and analytics, and then to work with our customers and wholesale partners to optimize pricing.

And so we're constantly--we try to avoid doing massive or shocking price increases. Now, obviously, between 2020 and today, there was some of that in certain categories, but we really seek to do smaller, more incremental, regular price that the market expects, that our customers are used to, that are easily digestible. And even at the peak in water, I think you never saw us move beyond mid-single digits. And if you do that consistently, and you do it all the time, you're able to create value for the entire value chain for all of our partners and do it in a way that you bring the consumer along, and I think that's reflected in the fact that we've been able to do it consistently, but still gain share as we were doing it.

John Lovallo
That's helpful. Thank you. And Nick, one of the comments that you made, and it's not unique to your business, but I would love to get your thoughts on it. DIY being a little bit softer than pro, in an environment where there's a little bit more challenge from an economic standpoint. I mean, intuitively, you would think it could be the opposite, where the consumer is trying to save some money by perhaps doing things a little bit more themselves. I mean, what do you think is driving this dynamic where the pro is holding up better?

Nicholas Fink
Yeah. I'll give you my hypothesis, for what it's worth. I think if you go back to sort of the fundamentals, right, you have a very, very unstable housing market and so you're going to see new construction. You've seen that come through, and the production builders have the systems and the processes, and they're excellent doing what they're doing, so you've seen them take share. And then you have a very aged housing stock, and so I think you're seeing consumers prioritize their homes and go after projects where they really need to bring their homes into a more modern era, and you've seen that hold up.

And I think what you've seen, what I'd say is relative weakness, is in the huge growth that we saw in kind of retail POS in 2021 and 2022, that we've caught up pretty consistently saying, coming into that spring selling period, really saw people go out and spend a lot in retail for kind of the spring into early summer months. My belief is a lot of that was stimulus driven. They had money, and we're probably doing projects that they wouldn't have otherwise done. And as we anticipated, if you now look at POS data, sequentially, the numbers improved week on week or week, as you sort of went through the late winter into the spring, as we would expect them to with normal seasonality, but they did not comp the the huge hill that was built the prior year when people went out and did a lot.

And interestingly, and consistent with that, as we've now gotten into kind of midsummer and you get past that hump, you can see those POS dollars come back into line, and closer to flat. I would say consistent with flat versus last year, consistent with what we would expect a normal season to look like. And so I guess to sum it up, I think, new construction, bigger projects, modernizing homes or building new homes continues to be driven. I think what we were digesting is a stimulus driven lap that was pretty tough. Surprised actually that we pretty much lapped '21 and '22. And then in '23, I think you did see sequential growth, there was just too big a lap without the support of those stimulus dollars.

John Lovallo
Got it. Thank you.

Nicholas Fink
Sure.

Operator
We have reached the end of the Q&A session and also, this concludes today's conference. We do thank you for joining today's conference call. You may now disconnect.