Fortune Brands Innovations, Inc.
Second Quarter 2026 Earnings Conference Call
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<u>Presenters</u>
Curt Worthington, Vice President, Finance and Investor Relations
Jesse Singh, Chief Executive Officer
Dave Barry, Chief Operating Officer
Ashley George, Interim Chief Financial Officer

<u>Q&A Participants</u>
Keith Hughes - Truist Securities
Matthew Bouley - Barclays Bank
Susan Maklari - Goldman Sachs
Mike Dahl - RBC Capital Markets
John Lovallo - UBS Investment Bank
Philip Ng - Jefferies
Trevor Allinson - Wolfe Research
Stephen Kim - Evercore ISI

Operator
Greetings, and welcome to the Fortune Brands Innovations Second Quarter 2026 Earnings Call.

At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press "*", "0" on your telephone keypad. Please note, this conference is being recorded.

I will now turn the conference over to your host, Curt Worthington, Vice President, Finance and Investor Relations. Thank you. You may begin.

Curt Worthington
Good afternoon, everyone, and welcome to the Fortune Brands Innovations second quarter 2026 earnings call. Hopefully, everyone has had a chance to review our earnings release. The earnings release, earnings presentation and audio replay of this call can be found on the Investors Section of our 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 our reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures.

With me on the call today are Jesse Singh, our new Chief Executive Officer, Dave Barry, our Chief Operating Officer, and Ashley George, our Interim Chief Financial Officer. Following our prepared remarks, we have allowed time to address questions.

With that, I will turn the call over to Jesse. Jesse.

Jesse Singh
Thank you, Curt, and good afternoon, everyone. I'm honored and energized to join Fortune Brands Innovations as Chief Executive Officer. Many thanks to the Board for its confidence and to Dave and the leadership team for the decisive actions they've taken over the past two quarters. I'd also like to thank the Fortune Brands team for their hard work through a period of change.

I have been here a month, and what I've seen so far has made me even more excited about the long-term opportunity to accelerate growth and expand margins. We have truly exceptional brands, talented people and decades of strong customer relationships, and our results over the last few years have lagged our potential.

We have great core businesses, including Moen, Therma-Tru, and Master Lock. We also have two relevant adjacencies that have become core to the company in our Moen Flo and our Yale Connected Locks business. We believe we have clear opportunities to expand our position and grow the market in each of these opportunities. We must continue to invest and expand in our core, while nurturing our adjacencies.

We also have very good people who want to do the right thing, but we as management have created conflicting priorities for our team members. Too much of our focus went to internal and corporate distractions and not enough to our customers. Our customers should be the center of everything we do.

Our intent is to get back to basics, better service, better products, and a simpler, more customer-focused organization. Ultimately, this should lead to a more efficient organization with better execution.

As part of this, we must address underperformance in parts of our core. Our Water business, for example, has a strong position in the market but has lagged, recently. This is driven by several factors, including service and supply chain challenges. We see opportunities in each of our businesses to improve the customer experience and to drive more focused innovation.

Our Doors business has an opportunity to drive incremental material conversion to our more resilient products. Our Security business has an opportunity to expand into additional categories, and we see opportunity for secular growth in our connected businesses. We are developing plans to address our gaps and realize these opportunities.

These plans may require incremental investments and resources to improve our service levels and to accelerate our new product development. We believe these actions will yield better long-term opportunity, growth, and profitability.

As part of our increased focus on the business, we intend to streamline our corporate cost structure and shift more resources to our customer-facing businesses.

There is real work underway, starting with the previously announced $70 million cost program and a detailed review of the portfolio to better align our resources with our core brands. We will continue to evaluate additional actions, as needed, to create a higher performing business.

By the end of the year, we intend to have the business realigned against these priorities. We will lay out more specifics on our plans over the next quarter or two, and you should expect to see progress against them, during 2027.

For the third quarter and the balance of the year, we are assuming a similar operating environment and commercial performance to what Dave and Ashley outlined, last quarter.

Our updated 2026 guidance is an acknowledgement that we may need to make investments in the company to enhance execution and drive long-term value creation and growth. While it will take time, I am confident that we can build a stronger company that will deliver improved results and shareholder value. We are taking the steps to ensure long-term growth and margin expansion.

With that, let me turn it over to Dave.

Dave Barry
Thanks, Jesse, and welcome. I'm looking forward to working together to improve execution and operational discipline in the company. As Jesse laid out his near-term priorities, my focus today is the specific actions to help us realize these objectives.

As Jesse noted, we are investing more aggressively in the near term to enhance execution and service, supported in part by the anticipated net tariff refund we recognized in the second quarter.

On our last call, we laid out our near-term priorities to improve performance and committed to taking decisive actions to achieve those priorities. On today's call, I'll provide an update on the actions we've taken, as well as share additional color on the specific steps that are underway. These are aligned to the priorities Jesse described: execution, including improving the customer experience and accelerating new product development, cost structure, and portfolio.

Starting with execution, there are still areas of underperformance that are impacting results, and we will continue to invest in improving our execution while working to streamline our business.

For example, last quarter, I described our efforts to reinvigorate our new product pipeline. These efforts remain underway, and we continue to build momentum into 2027. I'll point to two recent launches as indicators of our progress: Moen's Swivel Control faucet and Master Lock's Elite padlock.

The recently launched Swivel Control kitchen faucet is engineered to lock in place, providing better directional control, hands-free operation and automatic redocking. In conjunction with this rollout, we also launched a retrofit wand that allows existing Moen faucets to be equipped with the Swivel Control feature.

We are excited about these new introductions and initial response from consumers and our channel partners has been positive.

On the Security side, the Master Lock Elite padlock brings meaningful innovation to consumers and pros, including improved security features and enhanced materials. The lock's attributes address the number one concern of consumers: vulnerability to forced entry. The product, so far, is exceeding our sales expectations. We believe it will continue to gain placement across channels, through the balance of the year.

As I also noted last quarter, our sales and operations planning process has not kept pace with the needs of the business and our customers, which has contributed to service gaps. While we work to implement sustainable fixes, we are spending incrementally to ensure service targets are met. This performance is felt most acutely in Water, as our service challenges and related investments impacted top and bottom-line results in the quarter.

While we are making progress in improving our capabilities, we are not where we need to be, and we are prioritizing investments in our operations to improve service levels and accelerate new product development.

On the first quarter call, I spoke about optimizing our cost structure to enhance our business unit-led organization and simplifying our structure. During the quarter, we began the process of moving our brand, marketing, and advertising teams back into the business units. Over the past several years, we had centralized these capabilities, which created distance from our business unit teams, resulting in unnecessary cost and slowed execution. Bringing these functions back into the BUs puts brand and commercial decisions closer to the customer, removes layers, and accelerates decision-making.

In addition, work is underway to reduce corporate costs, and we have confidence in achieving the previously discussed annualized run rate savings target of approximately $70 million by the first quarter of 2027, with $15 million landing in 2026.

Further, we are actively exploring all aspects of our cost structure, and we anticipate ongoing efforts to better align our structure to business results.

Lastly, we also highlighted the portfolio as an area of opportunity, and our strategic review of Fiberon is underway, following through on the commitment we made last quarter to allocate capital and resources to our highest return opportunities. This is a deliberate step to concentrate investment and management attention on our core brands, where we have a clear right to win. We continue to evaluate select portions of our portfolio to drive additional improvements.

Turning to the market, within Repair and Remodel, we are seeing resilience in certain areas, particularly in luxury categories where the projects are less discretionary, even as consumers remain cautious, overall. We continue to expect the R&R end market to be down low single digits for the year.

Within single-family new construction, the spring selling season was relatively soft. As we discussed last quarter, our guidance does not contemplate a recovery in single-family new construction in 2026. We still expect this end market to be down mid-single digits for the year.

Looking at input costs, inflation continues to accelerate, especially oil derivatives and freight. We are monitoring the geopolitical backdrop, including potential outcomes that could ease energy and freight pressure and reduce input cost volatility. Given the uncertainty, our guidance does not assume any relief in commodity inflation, before year-end.

Additionally, we recognized a benefit from tariff refunds in the quarter. We have called out the net tariff benefit in our consolidated and segment financial results to allow investors to focus on the underlying performance of the business. We expect to use this benefit to invest in our business, including to support service, accelerate new product development, and increase brand awareness with consumers.

Looking ahead, IEEPA and expiring Section 122 tariffs have been replaced in kind by a combination of Section 232 and Section 301 tariffs, so our overall ongoing tariff exposure remains largely unchanged.

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

Ashley George
Thank you, Dave. As a reminder, my comments will focus on results before charges and gains, unless otherwise noted, and comparisons will be made against the prior year. Before I cover consolidated and segment results, I want to walk through the tariff refunds that we recognized in the quarter and the impact these had on our reported results.

Our presentation provides a breakdown of the gross and net impact of anticipated tariff refunds on reported operating income and EPS for the second quarter and full year 2026.

During the second quarter, we recognized $122 million in gross tariff refunds. Of this amount, $104 million was recognized as reduction in cost of goods during the second quarter. Net of directly attributable variable compensation expense, this translated to $81 million of operating income, 700 basis points of operating margin, and $0.52 of EPS in the quarter.

The remaining $18 million of gross refunds was recognized as a reduction in inventory, which will flow through our P&L in the second half. We expect this to be fully offset by the remaining portion of the directly attributable variable compensation expense.

Given the uncertainty regarding the amount and timing of any additional tariff refunds, we are not forecasting an incremental net benefit in the second half. As the situation evolves, we will update our guidance, accordingly.

In the second quarter, we had a cash inflow of $9 million from tariff refunds, and through July 31st, we have collected approximately $56 million of gross proceeds. Although we do not have specific guidance on the timing of the remaining refunds, we expect to receive the majority before year-end 2026.

Now, turning to our consolidated results for the quarter. Total company sales were $1.2 billion, down 4%. The decline in sales was primarily driven by our Water segment, partially offset by areas of growth in Outdoors and Security.

Consolidated operating income for the quarter was $236 million, up 18.4%, with margin of 20.4%, up 390 basis points. Second quarter EPS was $1.35. Both operating income and EPS benefited from anticipated net tariff refunds. Excluding this benefit, our second quarter results were in line with expectations.

Turning to our segment results, sales for Water were $605 million, down 6.5%. Excluding China, sales were down 5.4%. Sales were impacted by service level challenges, the carryover of discrete share losses from the first half of 2025 and softness in new construction related demand in our wholesale channel. These were partially offset by continued growth in the e-commerce channel.

Water's operating income was $179 million, up 7.9%, with margin of 29.5%, up 390 basis points. Operating income reflects a $66 million benefit from anticipated net tariff refunds, equating to 1,090 basis points of margin. Excluding this benefit, the underlying margin decline was driven by unfavorable price cost, volume deleverage and higher cost to serve our customers.

In Outdoors, sales for the quarter were $365 million, down 3.8%. Excluding Fiberon, sales were down 1.5%, driven by softer new construction related demand in the wholesale channel, partially offset by growth in retail and positive year-over-year pricing. In addition, Larson performed well as the NIL reset continued to gain momentum.

Outdoors operating income was $56 million, up 14.2%, with operating margin of 15.2%, up 240 basis points, reflecting the inclusion of $5 million of anticipated net tariff refunds and improved operating performance. This was partially offset by lower volume and higher tariff commodity and freight costs, particularly for Larson. Anticipated net tariff refunds benefited operating margin by 130 basis points in the quarter.

Turning to Security, sales for the quarter were $184 million, up 3.8%, with growth in the commercial, retail, and e-commerce channels. As we highlighted last quarter, we launched a number of new products across Yale and Master Lock, along with the Master Lock retail packaging refresh, during the second quarter. Early feedback has been positive, and we estimate that new products contributed almost 200 basis points to sales growth in the quarter. We expect these initiatives to continue to benefit the back half of the year.

Security's operating income was $50 million, up 88.2%, with operating margin of 26.8%, up 1,200 basis points, reflecting the inclusion of $19 million of anticipated net tariff refunds and improved operating performance, partially offset by higher tariff, commodity and freight costs.
Anticipated net tariff refunds benefited operating margin by 1,030 basis points in the quarter.

Turning to the balance sheet and cash flow, free cash flow for the quarter was $179 million, compared to $119 million last year, primarily reflecting a reduction in inventory during the second quarter. We ended the quarter with net debt of approximately $2.3 billion and net debt to EBITDA of 2.7 times. We are working to reduce leverage below 2.5 times through a reduction in debt levels, funded through free cash flow generation.

On capital allocation, our overarching goal is to maximize free cash flow. From that, we are prioritizing reinvestment in the business to reinvigorate our product pipeline, enhance execution and ultimately drive growth, after which we will look to return capital to our shareholders.

As we focus on improving our performance, we plan to prioritize organic investment over M&A, while balancing our share repurchases with achieving our near-term leverage target of 2.5 times.

Turning to guidance, our operating environment and commercial performance are largely consistent with what we outlined on our last call. As a result, our net sales guidance of down low single digits is unchanged. However, we now expect to be slightly below the midpoint of that range, as the previously mentioned execution challenges will continue to weigh on volumes and limit the improvement we originally expected in the second half.

We are updating our full-year EPS guidance to a range of $3.22-$3.52, which includes a benefit of $0.52 from anticipated net tariff refunds.

If you exclude this benefit, it implies full-year EPS of $2.70-$3, reflecting the investments we expect to make to improve service levels, accelerate new product development and enhance execution, coupled with slightly lower sales growth.

Our full-year free cash flow guidance incorporates net cash proceeds of $56 million from the tariff refunds received to date, partially offset by the reduction in our forecasted operating income in the second half of the year.

For the second half, we expect a modest improvement in net sales relative to the first half but still down year-over-year, driven by more favorable retail comps in Water and new product launches in Security. On a year-over-year basis, we expect price cost to be unfavorable in the third quarter and favorable in the fourth quarter.

At the midpoint of our guidance range, we expect second half margins to be up approximately 100 basis points versus the first half.

Looking at the third quarter, we expect net sales to be down between 1% and 2% and EPS to be between $0.72-$0.76, which assumes operating margin between 12.5% and 13%. As Jesse and Dave shared, we still have work to do to improve our execution, optimize our cost structure and realign our business. While these actions will take time, we are confident that with the right focus and investment, we can set the company up for a stronger future.

With that, I'll turn the call back to Curt.

Curt Worthington
Thanks, Ashley. That concludes our prepared remarks. We will now begin the question-and-answer session. Since there may be a number of you who would like to ask a question, we will ask that you limit your initial questions to two, and then reenter the queue to ask additional questions. Operator, can you open up the line? Thank you.

Operator
Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press "*", "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. Please limit yourself to one question and one follow-up. You may press "*", "2" 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.
And our first question will come from Keith Hughes with Truist Securities.

Keith Hughes
Thank you. Jesse, question for you. You've been at the company for about a month now. If you could just talk about, after your month there, what you think the biggest opportunities are at Fortune Brands, and flip side, what's some of the biggest challenges you face?

Jesse Singh
Yeah, first off, thanks for the question, Keith. I came into the role assuming that this business had long-term sustainable growth potential and margin potential capacity. I tell you, coming in after the first month, if anything, I'm even more optimistic about that long-term opportunity.

If you think about the strength that we have established over the years, we've got a diverse portfolio. We play in three really good markets. We've already made the investments necessary in our adjacency in the connected space. I've been pleasantly surprised with the talent that we have. I've been impressed that despite a bit of change in the organization, including at the top, the team, over the last few months, has really been focused on building out new product pipelines. The brands continue to be really relevant in the market.

And I think one of the other things that, as you know from my previous company, you look for, is there growth opportunity that can come from expanding from where you are. Whether that be some kind of a material conversion or really expanding the market into other categories.

And really, I've been pleasantly surprised in the early discussions across all of our businesses, those kinds of opportunities exist. Obviously, in a business like Therma-Tru, there's more material conversion opportunity. In Connected Home, there continues to be opportunity where that market is just growing. In our core Water business, there also continues to be opportunity to really expand the pie.

In terms of some of the challenges, I think we've touched upon them on the call. We need to get back to making sure that we deliver a really good service level to our core. There's been good progress there. We're going to have to continue down that journey.

I also think we've just been way too complex, and I highlighted that in my comments on the call. We've had a complex organization that the team has had to work through. I think as we simplify that and bring the discussion down to how do we continue to grow and execute in each of these important businesses, I think we'll start seeing the results.

Keith Hughes
Okay, great. One other question. I was interested in Dave's comments of you're moving the marketing and advertising, etc., back into the field, if you will, which is great news. How long will you take? Will you be able to get that done by the end of the year, I guess, is really the question.

Jesse Singh
Yeah, look, I'm glad you pointed out Dave's comments. I think Dave did a terrific job in the short time that he had to start to move back in that direction. I think we're looking at ways to align the business to really align the overall structure to really give our businesses a chance to aggressively execute. I would expect that we'll continue to refine that, and we'll make really good progress in the months to come. We would expect to be in a really good position by the end of the year.

Dave Barry
If you think about it, we talked about it last quarter, fundamentally, it's about getting these resources of ours closer to the business to increase execution and efficiency and really become more customer-focused. As Jesse called out, we have great people who are in roles now. We have critical talent. It's really getting those people set up for success and getting our business

set up for success by putting them in the right spot in the organization. So that work's underway with pace, right now.

Keith Hughes
Okay, great. Thank you.

Operator
Our next question will come from Matthew Bouley with Barclays.

Matthew Bouley
Good evening, everyone. Thanks for taking the questions, and welcome back to all the fun, Jesse.

Jesse Singh
Good to talk to you, too, Matt.

Matthew Bouley
Just one on sort of the maybe how you're thinking about the cost outlook here. If I'm hearing everything correctly, you sort of had this, I guess, fortuitous opportunity to take these tariff refunds and you needed to be reinvesting, and you're using that to reinvest here. And it sounds like maybe there's some front-loading but at the same time, you see kind of a longer-term opportunity to really streamline the corporate structure of the business.

My question is basically timing and magnitude there. How should we think about what needs to be reinvested into the business and then, at what point could we really begin to see the sort of fruits of those efforts, and how do you think about that ongoing cost structure of the business? Thank you.

Jesse Singh
Yeah, look, I really appreciate the question, and it is certainly the right question for the long term. I would say it's too early to give you a cadence of that combination of reallocating resources and what's the overall ramifications. I think with our current guidance, there's an acknowledgment that that balancing act may require some investment before the comps are fully realigned. Without being too specific, we'd be hopeful that we could make progress against that balance, sometime during 2027. I think for the long term, I think that there's certainly opportunity to increase resourcing in the business, while we are driving SG&A efficiency.

Dave Barry
Yeah, and Matt, maybe I'd add, the areas where we're investing, we would have addressed those areas regardless of the tariff refund, as they're core to protecting the business, the revenue, and the future of the business. With Jesse on board, we're using it as an opportunity to be more aggressive and accelerate those investments here in the near term, so that we set ourselves up for success in 2027.

Matthew Bouley
Got you. Okay, yeah. No, got you loud and clear and appreciated that a lot of this is still kind of to be determined. Maybe second one, just kind of jumping down into the model and the numbers and on the water business, appreciating there's a lot of moving pieces with the tariff refund there in terms of the margin. Obviously, we saw your peer report, last week.

Maybe you can kind of break out sort of underlying market performance in the water industry, how volumes and price are tracking and sort of within the guide, how you're expecting all of that, both top line and the margin cadence in the second half to play out. Thank you.

Ashley George
Hey, Matt. Thanks for the question. Let me maybe jump in with some of our numbers and drivers for water in the quarter, and then I'll have Dave add some color. If you look at this business, clearly not performing where we want it to. Sales down 5.4% in the quarter, excluding China.

That is price up low single digits, volume down high single digits. I think about drivers in the quarter, I think about it as two primary drivers, both driving about half of that net sales decline. The first one is the carryover from discrete share loss in the first half of last year that we've talked about and then the second driver were the service challenges in the quarter that we talked about. There's some other puts and takes, but I think about those as the two primary drivers for Q2.

Probably worth saying, as well, that our luxury segment continues to outperform. Our House of Rohl sales performance was better than the Moen business in the quarter. Let me flip to operating margin, then we can add some color. From a margin standpoint, if you take out the impacts of tariff refunds and do the math, you get operating margin down 700 basis points versus prior year. Three big drivers. About half of that's coming from price cost. That was as we expected in the quarter. You've got another roughly 200 basis points coming from some of the service challenges, incremental costs that we incurred to serve our customers in the quarter, and then the remaining really comes from volume de-leverage.

So, if you back out the service challenge impact of 200 basis points in the quarter, you get to something that was in line with our expectations coming out of Q1.

Dave Barry
I think that's a critical point. Matt, if we step back and just look at the Water business, commercially, largely performing in line with our expectations a quarter ago. As Ashley alluded to, the top line was impacted, call it two and a half percentage points on the sales line from service and inability to fulfill the demand. That's one of the areas we're focused on investing.

We will continue to spend on premium freight. We'll continue to spend in our DCs. We will look at sourcing, even if it's from a higher cost supplier that can be more delivery focused and get our products more consistently.

Looking at the margin, what really was different was that premium cost to serve from a quarter ago, so we'll continue to spend there. That'll be investments through the second half.

As we look forward and you think about where Water margins could go from here, right, there's still pretty significant price cost headwinds in the third quarter. They start to ease a bit from the 380 basis points, but they're still significant. That starts to turn more favorable in the fourth quarter and then as we sustainably solve our demand planning and service challenges, that can become a tailwind as you move into 2027

So, I do think the next couple quarters probably represent more of a trough for Water margins, and then you start to see them build back as we move into next year.

Matthew Bouley
All right. Well, that's perfect. Really great color. Appreciate it, guys. Good luck.

Dave Barry
Thank you.

Ashley George
Thank you, Matt.

Operator
We'll go next to Susan Maklari with Goldman Sachs.

Susan Maklari
Thank you. Good afternoon, everyone. Welcome back, Jesse.

Jesse Singh
Thanks, Susan.

Susan Maklari
My first question is, at a higher level, can you help us bridge the revised earnings guide of $2.70-$3, relative to the prior guide of $3-$3.30? Can you just kind of walk through the puts and takes there that we should be thinking about?

Jesse Singh
Yeah. Just at a high level, and I'll let Dave provide a bit more color, at a high level, from a commercial standpoint, as Ashley highlighted, the business is operating similar to what was discussed on the last quarter.

I think there's really two components to the adjustment. I think number one is there's an acknowledgment that incremental expense would provide incrementally better service, which we think is the right thing for our customers. I think the second component is we are starting the journey of accelerating certain investments that we believe will start to put the business back on a growth trajectory. And the most obvious one is, I highlighted that we have a pretty good and accelerating portfolio of potentially new products.

We see terrific opportunity, and I'll give a Security example, we launched a more premium lock recently. It's doing well. We see opportunity to continue to expand that portfolio and other products like that. We want to find ways to accelerate that, those types of products.

I think, similarly, we see really good material conversion opportunity in our Doors business. We want to make sure that we take the steps to accelerate those types of products. Then there'll be some incremental additional investments related to growth.

Dave Barry
Yeah, I'd add, just to put some numbers behind it, Sue, if you think about the $0.30 drop in EPS at the midpoint, I think of it as $0.20 or so of investment that Jesse outlined, and then call it $0.10 or so of volume but really volume directly attributable to service constraints. And so, another good example where we're having some strong success with Yale in multifamily, we're choosing to really prioritize that volume at the expense of maybe running an incremental promotion that might overwhelm some of our service.

So, it's really continuing to focus in on where can we serve, where are we winning, how do we prioritize that volume and dialing back some of the extra things here in the near term, while we get everything more sustainable going forward.

Susan Maklari
Okay. That's very helpful color. Then maybe turning to the various priorities that you outlined, the execution, investing in service, optimizing the cost structure, reviewing the portfolio. Can you give us some sense of which of those we should expect to come through in the near term, maybe within the next couple quarters, the next year, versus are there some of those that will be a bit longer in their nature and take more time to work through and come through to the results?

Jesse Singh
At a high level, and I'll ask Dave to comment, I think there's activities in each of the areas you talked about, and think of it as customer experience, improvement on our execution, and that includes realignment of the organization, new product growth, and an increase of investment in our core. If you just take that as a high level of what you just laid out, we're taking action on all of those things, right now. We would hope to see progress from those actions, as we move through 2027.

Obviously, growth tends to be a longer cycle activity, especially new product growth, so that may take a bit longer. But certainly, as we look to streamline our execution, improve our service, simplify our organization, all of those sorts of things, you're going to start to see the benefit of that, as we move early into 2027.

Dave Barry

Yeah, as we said in the prepared remarks, we're on track for delivering the $70 million cost out, separate from the investments that we're making in the near term to continue to improve the performance of the business. And to Jesse's point on new products, I think we talked about this last quarter, as we're rebuilding that pipeline and trying to pull things through faster, that could be a two, three, four-quarter lag because by the time you launch a product, you get placement, the shelf resets, it can take that long.

So, I think new product may be more impactful as you move into the second half of next year, even though we're starting to see some wins now but should have the initial wave of cost out behind us in the first quarter.

Susan Maklari
Okay. All right. That's great color. Thank you, both, and good luck with the quarter.

Dave Barry
Thanks, Sue.

Jesse Singh
Thanks, Sue.

Operator
We'll hear next from Mike Dahl with RBC Capital Markets.

Mike Dahl
Hi, thanks for taking my questions. Welcome back, Jesse, and congrats to you and Dave, both, in the new roles.

Jesse Singh
Thanks, Mike.

Dave Barry
Thanks, Mike.

Mike Dahl
I also wanted to follow up on kind of the investment dynamic, just to make sure we have a clear picture of it. You've outlined a couple of things kind of high level in terms of it sounds like a lot of this is in Water, but then there's some new product-oriented dynamics. Can you just give us a little bit more of a detailed kind of bridge on, or quantification of where these investments are sitting in terms of both by category or by segment, just to help us understand that second half dynamic a little bit more?

Dave Barry
Yeah, I'd contextualize it a bit, Mike, based on performance and Outdoors and Security largely performing as expected through those businesses. I think the opportunity there is to invest to accelerate that performance, so you'll see new product investment going into Outdoors and

Security. You'll see commercialization investment in both of those businesses to accelerate the new products that we've launched. Then, we have a Master Lock brand campaign that's performing really well, so we'll continue to invest behind that.

On the water side, it's the biggest piece of our business. It's the piece that is performing probably below expectations at the moment. The bulk of the investment will be directed towards water, especially on the service side, as we look to continue to spend to service our customers.

Mike Dahl
Okay.

Jesse Singh
Let me put a little bit of a context. I realize we're talking about service, and just to put a little bit of a context on how we arrived at some of these service issues, we made some systems changes and some organizational changes and for the right reasons. We also made some supply chain changes as our supply chain was under stress during the initial and multiple rounds of tariffs.

And so, the outcome of that is we created some disruption in our supply chain and, therefore, some disruption in our service. A lot of what we're talking about is getting back to a stable supply chain, getting back to stable S&OP processes, going back to our core systems that we were using and getting back to what we would consider a baseline of performance. So, what we're talking about here is it's not a unique and unknown problem to solve. We're bringing the organization back to stability, after a year of some changes.

Mike Dahl
Yeah, that's helpful detail. Maybe just a clarification and then a second question. Just on the supply chain dynamic, I know you guys were working hard and aggressively to move costs out of China. Is that effectively like some of that backfired and now that you know the better way, we think maybe a more stable way of the land in terms of new tariff dynamics, there's some re-shifting in some of the global supply chain?

Then, my real follow-up question was, a lot of this discussion on investment sounds very kind of OpEx oriented. What's your view on your physical capacity footprint, Jesse, and any early thoughts on kind of puts and takes as you think about CapEx, going forward?

Jesse Singh
Initially, we've got plenty of capacity in our facilities, and we have the capability. This is not as capital-intensive a business as you and I have discussed in the past. So I feel pretty good, and I'll let Dave comment just on our capital footprint. Look, there might be some capitalization on either R&D or on systems investments but in terms of hard assets, there's always a little bit of incremental here and there, but we're in a pretty good spot.

Maybe to answer your question on the supply chain, there's some good decisions being made but sometimes in the execution on the pitch and catch, the organization that's receiving the supply may not have been ready for the volume.

And so, we're going to make sure we take a look at what's the right supply chain footprint to have, what's the right way to manage that, and we might be a little bit more cautious than we were in the past to make sure that as we execute any changes, and there's always some changes, that we do it in a way that is probably a bit more methodical. I

And in the short term, that may lead to slightly higher costs in the moment, but it might be the right thing for our customers and the right thing for long-term growth.

Dave Barry
I think on the capacity point, Mike, if you think about our CapEx, and we've talked about this in the past, we're roughly 1% of sales maintenance CapEx in the balance for growth, new products, and cost out. If you look at the guide, the CapEx guide, $110 million-$125 million, lower than it's been in years past. I think we had more capacity investments in years past and now feel like we're well-positioned to absorb incremental volume in the future years.

Mike Dahl
That's great. Thank you.

Operator
Our next question will come from John Lovallo with UBS.

John Lovallo
Hey, good afternoon, guys, and thanks for taking my questions and Jesse, good to hear your voice. The third quarter operating margin of 12.5%-13%, that's inclusive of the $18 million good guy in inventory that's coming through COGS in the quarter, correct? And if so, how should we sort of think about margin pressure across segments?

Ashley George
Yeah, let me start. In Q3, it does include the incremental refund coming off the balance sheet but important to note that'll be offset with the directly attributable variable comp, and some of that'll hit in Q3 and Q4, but that will essentially offset that net benefit in the second half.

Q3 margins, if you think about it sequentially, off of Q2, I would think about some favorability coming from price cost as that starts to improve sequentially in Q3, although we don't see the year-on-year improvement till Q4. But then that is offset by both volume leverage and SG&A from the investments to drive execution we've been talking about. So, net down sequentially, price cost up investments, price cost favorable investments unfavorable.

Dave Barry
The only thing I'd add to that, John, prior year, there was a benefit from variable comp unwind, and it was pretty sizable in the quarter, last year. It was about $25 million or 270 basis points, so

we're comping that benefit from last year. Otherwise, agree with what Ashley said. Price cost gets a little bit better sequentially. It's still unfavorable, and you have some volume deleverage on the margin.

John Lovallo
Okay, got you, okay. All right, if we think about that SG&A in the quarter, dollars were up 4% year-over-year, I think, on a 4% decline in revenue. I think as a % of sales. SG&A was up 230 basis points. I thought that there may have been some incentive comp in that, but it appears like there may not have been. So, what sort of drove that outside of a little bit of deleverage?

Dave Barry
No, there is incentive comp. I was talking third quarter, John.

John Lovallo
Yeah.

Dave Barry
Last year's prior comp was third quarter, second quarter.

John Lovallo
No, right.

Dave Barry
You have the tariff-related directly attributable incentive comp in SG&A.

John Lovallo
Okay, so it did hit in the second quarter.

Dave Barry
Correct. Yes.

Ashley George
Yeah.

John Lovallo
Got it. Thank you, guys.

Operator
We'll go next to Phil Ng with Jefferies.

Phil Ng
Hey, guys. Jesse, welcome back.

Jesse Singh Thanks, Phil.

Phil Ng
In your past role, I would say you were super collaborative with the channel. What's the early feedback? What are you hearing from your channel partners? Are there areas where perhaps you need to realign who you work with, particularly on the plumbing side where you're oversupplied, undersupplied? Areas where you think you could fill a void perhaps where you're under-penetrated, like e-com. Just give us an early read in terms of what you're hearing in opportunities on the channel side of things.

Jesse Singh
Yeah, appreciate the question, Phil. What I would say is, just in aggregate, across the board, coming into this role, I've been very pleased that we've got brands that matter and brands that are relevant to each of our channel partners, so that's a good place to start.

I think if you look in each of our businesses, there's opportunity for us in all channels, and there's certainly some channels where I would say we are under-penetrated, where I think there'll be an opportunity with better execution and correct products, where we'll just have more opportunity and more of a chance to have growth in some of those segments. Once again, it's going to vary by each part of our portfolio, but I think it's safe to say, look, I'll give you a macro without being too specific.

I think in a couple of our businesses, be it Water or doors, we've got a great position with new construction, single-family new construction, which I think is always, for the long term, going to be a good segment. But in general, in both those businesses, we are under-indexed in the R&R-oriented side of the business. Obviously, R&R has been more stable, and is complex, it's broad, it's multiple channels, multiple customer sets. There'll be an opportunity for both those businesses to continue to expand into that part of the housing sector.

Phil Ng
Okay, that's helpful. Perhaps a question for Ashley. In the press release, you guys provided some color in terms of Outdoors sales and how that would look like, without Fiberon. Not going too deep, any color when we think about how that portfolio could look like, over time, with some of the cost-out actions in that same format with or without some of those dynamics, how should we think about the opportunity for that margin profile opportunity for Outdoors, going forward?

Dave Barry
Yeah, it's Dave, maybe I'll take this at a high level. It is hard to get into details when we're in an active strategic review of the business. But I'd say, what we have in our Doors business, we feel really good about the strength that we have within Therma-Tru. It's a material conversion story that still hasn't fully played out. As Jesse referenced, Doors are probably 55% converted right now away from wood and steel. We see really secular growth opportunities in Therma-Tru, and we are the leader there in that space.

And then Larson, the reset that happened at our retail partner continues to go really well, and we continue to work through that product portfolio, so we see Larson growing POS, growing share, and performing really well. And I think it's a good example of what we can do when we get it right around new product and commercialization with a strong partner. So, happy with the Doors business, and we'll continue to move with pace on the strategic review of Fiberon.

Phil Ng
Okay. Thank you for the color, guys. Really appreciate it.

Operator
And moving next to Trevor Allinson with Wolfe Research.

Trevor Allinson
Hi. Good morning -- or good evening. Thank you for taking my questions. First one on the kind of overall portfolio and going back to the Fiberon strategic review. What's kind of the timeline for completion there? Then as we think about the portfolio more generally, how should we think about other parts of that business, or other parts of your business, overall? Could there be other companies that you look at as maybe not being core for you guys, moving forward?

Dave Barry
Yeah, hey, Trevor. I'll take Fiberon and let Jesse comment on the portfolio. I'll say we've retained advisors, and I'm pleased with the progress we're making against identifying the appropriate outcome which for us, looking to maximize value for our shareholders and also set the business up for success with our customers and our employees. So, I can't commit to a timeline on the call, but we're moving with pace and pleased with where we are. Jesse.

Jesse Singh
Yeah, just on the overall portfolio. I would think of it maybe in pockets at a more granular level, which we want to make sure we're in a really good position to win and continue to expand.

So, against that, we'll take a look at certain product lines, certain kind of subsegments, potentially within our aggregate portfolio to see if there's opportunity there. But in general, if you look at the -- effectively, the three core pillars plus the adjacent pillar with our interconnected business that I just talked about, we feel really good about each of those pillars and our ability to win and expand in each of those pillars. But there might be tweaks that occur within those pillars to optimize it. It's still early, and we'll keep you updated on that.

Trevor Allinson
Okay. Appreciate all that color. Second one would be on your inflation expectations across the business in 2026, specifically in Water, just given the movement in copper and zinc prices, year-to-date. How should we think about the inflation across those businesses and across the entire year, and then perhaps also some commentary on exit rate inflation. Thanks.

Ashley George
Yeah, I'll start. If we look at inflation for the year, pretty consistent with what we've talked about full year, previously. So, we've got about $100 million year-over-year increase in tariff hitting the P&L in year. Now remember, a larger portion of that hit in the first half. Then we are increasing

our commodity estimate from $80 million incremental to $90 million incremental, so a $10 million increase in commodity and freight inflation driven across brass, copper, aluminum, and freight.

I'd say, as we look at where we are in year, our commodities tend to be pretty locked based on the timing of when they hit the P&L. But s we assess 2027 and sort of where we're coming out of this year, I'd say we're in the early planning phases, so probably too early to comment on any specific numbers.

But the way the cadence usually works is it gives us time as we get in the planning process to look and assess those commodity increases against our pricing in the market, so we'll do that holistically, as part of our 2027 planning.

Trevor Allinson
Thanks for all the color. Welcome back, Jesse, and good luck moving forward.

Jesse Singh
Thank you. Talk soon.

Operator
And our next question will come from Stephen Kim with Evercore ISI.

Stephen Kim
Yeah, thanks very much, guys. Appreciate all the color, so far. Welcome, Jesse.

Jesse Singh
Thanks, Stephen.

Stephen Kim
My first question relates to the incremental investments. If my math's right, it seems like you're talking about, call it $45 million-$50 million, or whatever, of incremental investments, this year. I think you said about a third of that's going to be due to addressing service issues and, hopefully, getting some volume from that. About the other two-thirds would be from initiatives like new products.

So, first question is, where do these investments hit the P&L? Secondly, could you give us an understanding as to how you are going to boost near-term product launch productivity through incremental investments? Is this basically just marketing expense? Is this going to be some sort of increased incentives of some kind? Just give us a sense for how those dollars are going to be allocated.

Dave Barry
Yeah, I'm happy to start on that. Stephen, just to, I think, clarify a bit, on the investment side, what we talked about was roughly $0.20 of EPS, so call it $30 million or so. I'd say predominantly hit through OpEx, mostly in SG&A as we move through the balance of the year,

maybe a bit in COGS if we move some of the sourcing around that we're looking at. So, I think that's how you should think about it flowing through the P&L.

And then on the new product side, a few things we can do there, right? Commercialization, as you touched on, is one of them and just as we launch products, making sure we're supporting them in the marketplace. Also, there's opportunity to co-invest with some suppliers to develop technologies, faster. I think we may have touched on it on the last call but one area of opportunity, broadly for new products to bring them to market faster, is to work more closely with our sophisticated supply base to do that.

So, lean in there, then really just incremental resources where the team needs them to pull projects in faster. So, it's a focus we've talked about now for a couple of quarters to get this new product development engine going, and we're pleased with initial results but know we have a lot of work left ahead of us.

Stephen Kim
Got you. Okay, that's helpful. When you talk about service, you've talked about service a number of times, obviously. And it seemed like, I think you had indicated that that was something which was the main difference from your expectations in your Water performance, if I heard Ashley right on the operating margin bridge.

I was curious if you could sort of talk a little bit more about, specifically, what the issue is there. It sounds to me like it's not a suboptimal geographic supply chain, from an earlier question. It seems like it maybe is more a systems or a software issue that I guess you've arrived at a solution on. If you could just give us a little bit of color there.

Then also, you called this out, I think as some of the main delta from your expectations in Water. And I'm curious, was there some sort of discrete event that hit this particular quarter? Because I know that service levels is something that you were focused on three, six months ago as well, so I would have expected that you would have expected something in 2Q, already, so if you could just provide some color there. Thanks.

Jesse Singh
I'll start and let Dave chime in. In terms of discrete, think of it as expedited freight and costs of expediting product in order to make sure that we sustain delivery to our channel partners. And so, we're working our way through that. There might be some additional expedited freight, and we've got a number of SKUs across a number of different product categories. There's different reasons for that.

In some cases, it was an outcome of a change of a source of supply where the receiving supply couldn't ramp up fast enough. In other cases, it was, as I described earlier and as you highlighted, some systemic issues, right? So, without getting into too much detail, the organization's gone through a lot of change in the last six to 12 months, in particular.

And as part of that change, we made some alterations to the systems we use to conduct our S&OP and in effect, the new process and new systems did not deliver the required levels of inventory to be able to service our customers. I hate to say it, but it's that simple.

I could give you a positive spin, but those of you that know me know I'm not going to do that. We had a few misses, so we're resetting back to the old process that allowed us to consistently deliver for years, and we're going back to what we were doing earlier.

Once again, the intent was positive, the blend of systems and organizational changes, the intent was to have higher service at lower inventory. And hat just didn't work out, so we're addressing that issue.

Stephen Kim
Got you. Thank you.

Operator
This now concludes our question and answer session. I would like to turn the floor back over to Jesse Singh for closing comments.

Jesse Singh
Thank you all for engaging with us, tonight. We are really excited about the opportunity that's ahead of us. As I mentioned earlier in the call, we are confident that we've got a terrific opportunity here to start to accelerate this business. It will require some additional investment, as we've talked about, and I'm confident that we've got the right team here to continue to progress this, and what we talked about today is a first step in that direction.

With that, look forward to chatting with many of you in subsequent events. Thanks, and have a great evening.

Operator
Ladies and gentlemen, thank you for your participation. This does conclude today's teleconference. You may disconnect your lines, and have a wonderful day.