



**Fortune Brands Innovations, Inc.**  
**Third Quarter 2024 Earnings Conference Call**  
**November 6, 2024**

---

**Presenters**

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

**Nick Fink, Chief Executive Officer**

**Dave Barry, Chief Financial Officer**

**Q&A Participants**

**John Lovallo - UBS**

**Philip Ng - Jefferies**

**Mike Dahl - RBC Capital Markets**

**Trevor Allinson - Wolfe Research**

**Stephen Kim - Evercore ISI**

**Adam Baumgarten - Zelman**

**Matt Bouley - Barclays**

**Operator**

Good day, ladies and gentlemen. My name is Morgan, and I will be your conference operator today. I'd like to welcome you to the Fortune Brands Third Quarter 2024 Earnings Conference Call.

All lines have been placed on mute to prevent any background noise. Following the speakers' remarks, we will open the call for a question-and-answer session.

At this time, I'd like to turn the call over to Leigh Avsec, Vice President of Investor Relations and Corporate Affairs. Leigh, please go ahead.

**Leigh Avsec**

Good afternoon, everyone, and welcome to the Fortune Brands Innovations third quarter 2024 earnings call. Hopefully, everyone has had a chance to review the earnings release and our supplemental financials. The earnings release and the audio replay of this call can be found in the Investors section of our website.

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

These risks are detailed in our various filings with the SEC. The company does not undertake any obligation to update or revise any forward-looking statements, except as required by law. Any references

to operating profit or margin, earnings per share or free cash flow on today's call will focus on our results on a before charges and gains basis, unless otherwise specified. Please visit our website for reconciliations.

With me on the call today are Nick Fink, our Chief Executive Officer, and Dave Barry, our Chief Financial Officer. Following the 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 thanks to everyone for joining us, today. On this call, I will walk through the highlights of our third quarter performance, give some color on the drivers of this performance, including progress on our digital strategy, and offer some thoughts on the macro environment. I'll then turn the call over to Dave for a more detailed discussion of our financial results, our updates to our guidance for the remainder of 2024, as well as some thoughts on our emerging expectations for 2025.

Before turning to our third quarter performance, I would like to provide some context around our market. While we are increasingly excited about the long-term opportunities in our space and for our company, we continue to operate in a choppy environment with continuous year-over-year U.S. repair and remodel declines and unprecedented market disruption in China.

Our seasoned team is managing our business tightly, while continuing to prioritize investments in our strategic growth priorities, including our digital transformation.

We have purposely moved away from less profitable categories to focus our resources on our supercharged higher-margin opportunities. We continue to streamline our operating model, which has allowed us to operate more efficiently, reduce SG&A and fuel growth.

While our short-term results remain pressured in a demand-challenged environment, we are already seeing tangible results from the strategic actions and investments undertaken to advance our longer-term growth opportunities.

As in Q2, we saw areas of sales strength in our core North American Moen and Therma-Tru businesses. Our digital products portfolio, once again, saw some very exciting wins this past quarter and the organization continues to ramp our sales pipeline.

Finally, as we approach the two-year anniversary of our new operating model, we are working as a more aligned and efficient organization, including developing new marketing campaigns, launching new products faster and building a new company purpose. This new purpose, which better captures the ambition of Fortune Brands Innovations, will help unify and motivate all 11,000 associates across the globe behind our unique opportunity.

Net sales were \$1.2 billion in the quarter, down 8%, excluding China, which was again impacted by lower sales as the Chinese consumer remained very cautious. Our organic sales were down 5% in the quarter. Importantly, point-of-sale, excluding China, was down low-single-digits.

We have now annualized the sales of Emtex, Yale and August into our organic results. When you're following this transaction, we remain very pleased with their performance, as well as how they have helped accelerate our transformation into a digital disruptive company and luxury goods powerhouse. We are fortunate for the exceptional talent that we acquired, along with these brands.

In the third quarter, we continued our trend of delivering strong margin results. Our operating margin in the quarter was 18.7%, up 130 basis points versus the third quarter of 2023. Our strong margin performance resulted from continuous improvement initiatives, targeted cost reduction activities, as well as our continued focus on growing more profitable categories. These initiatives enabled us to continue to make key investments in the quarter. Our third quarter earnings per share were \$1.16, and our operating income was \$216 million.

Turning first to our digital portfolio. We have made excellent progress with our Flo strategy. We have now signed seven insurance contracts. These agreements feed our opportunity pipeline, creating leads, which we then convert into sales. In the third quarter alone, we added around 20,000 users of our Flo Smart Water Monitor and Shutoff.

In retail and e-commerce, POS performance was up 80% versus the third quarter of 2023, exceeding our expectations, as consumers increasingly gain awareness of the incredible value of our Flo device. We expect our Flo business to grow nicely in the fourth quarter of 2024 and expect this growth to accelerate, into 2025.

We currently have agreements in place covering approximately 8 million policyholders and are in active discussions with homeowner insurance companies representing around 60 million homeowners. We are also having continued conversations with municipalities and water utility companies across the country, including our recently announced partnership with Miami-Dade County.

To give a sense of the amount of sales we have coming down the pipeline, at a conservative 5% sales conversion assumption of the insurance agreements that we currently have under contract, the potential sales pipeline we currently have for Flo is over \$160 million. While the timing of this backlog is hard to predict, we reasonably expect to see these sales, soon. The significant progress we've made in just a few short months to expand the reach of our smart leak detection is truly impressive.

This past quarter, we again had some key wins in our digital product space and saw over 225,000 new device activations in the third quarter between both Water and Security and now have approximately 4.5 million users, across our digital platforms. This continued acceleration gives us confidence in the strong future of Fortune Brands as a digital leader.

In addition to the several large insurance partnerships with Flo, our Yale and August businesses made progress with some key customers, including integrations with ADT, ecobee and Airbnb. In addition, we are excited that our new most connected lockout/tagout solution is now in beta testing at several facilities. More to come on this, which we believe will be the next big breakout opportunity.

While our digital product journey is well on its way, we have much more runway ahead, as we are still learning the best and most efficient ways to get our products to our customers and partners. Expect more

from us as we continue to evolve this growth engine. As we stated last quarter, we see a path for well over \$1 billion in digital sales, by 2030.

Turning now to some thoughts on the current U.S. housing market and the market for our products. The external macro environment continues to be uneven and challenging. While the Fed lowered interest rates earlier this quarter, mortgage rates remain elevated above 6%, and many homebuyers and homeowners remain on the sidelines.

Repair and remodel data has generally stabilized relative to larger declines over the prior 12 months, albeit at a lower than historical rate, as consumers remain cautious. Notwithstanding the recent market softness, we continue to be very excited about our future, including in 2025.

Housing fundamentals remain positive with the need for housing remaining strong, home prices holding steady and equity levels exceeding \$35 trillion. As we continue to evolve our portfolio and focus on our supercharge categories and as we continue to build upon our already strong brands and introduce meaningful innovations, we expect that our products will further distinguish themselves.

With regards to the single-family new construction market, large builders continue to remain resilient as they use their balance sheets to lower mortgage rates and to help get people into new homes. We expect that large homebuilders will continue to gain share, and we have the added torque of the exposure to their growth.

While starts were down this summer, the home builder market is continuing to grow. In September, the single-family NAHB housing market index for sales expectations for the next six months were up 8% versus prior year, while builder sentiment was also improving.

Turning to repair and remodel. R&R is driven by several factors, including consumer confidence, employment levels, home equity levels and access to credit. Our R&R has been down over the last two years. We believe this has created unprecedented levels of pent-up demand with one recent estimate putting it at \$30 billion. As we previously mentioned, Americans have more than \$35 trillion in home equity, up 81% from the end of 2019.

However, the usage of equity extraction vehicles, like home equity loans and cash out refinancing has fallen, as rates remain high. In fact, the percentage of extracted home equity fell by more than half, since the fourth quarter of 2019. It is now estimated that over 14% of homeowners have mortgages above 6%, finally making refinancing a sensible option.

In addition, as the federal prime rate comes down next year, HELOCs and credit card rates should be more attractive, and we would expect more people to utilize them to finance their R&R projects. As interest rates decline and as mortgage lock-in effect subsides, we believe people will increasingly tap into their home equity for renovation projects through a variety of vehicles, including refinancing, HELOCs, key loans and home equity agreements.

Finally, we expect that there will be a short-term negative impact from the recent hurricanes on our fourth quarter sales, as we have seen this in our point-of-sale data. Our thoughts are with those impacted, and we have been providing products and assistance to those in need. We expect that there will be opportunities as communities rebuild in 2025, and our teams are working actively to capture this.

Additionally, these tragedies have put additional pressures on insurance companies to find innovative solutions to offset the losses that they can control, through devices like Flo. As Dave will detail more completely in his section, we are actively scenario planning for a variety of outcomes in 2025. We believe the demand environment in the U.S. will inflect positively, with the recovery more weighted to the second half of the year.

Additionally, as we complete our pivot from lower growth, less profitable categories to supercharged categories, our mix will help accelerate growth, regardless of the external conditions. We will focus on growing our core and accelerating our digital products, and we'll continue to invest behind our long-term growth priorities.

As we head toward the end of 2024 and set our sights on 2025, we are focused on execution and delivering on our commitment to above market sales growth and margin performance.

Turning now to an update on a key part of our transformation. As we approach the two-year anniversary of the cabinet spin-off and the reorganization of our business from a decentralized mechanical-only business into a digital innovator, I wanted to highlight a key milestone.

Over the past nine months, we leveraged associate feedback and senior leader conversations to develop a new purpose statement with supporting strategic drivers, and behaviors. This new purpose captures the unique opportunities Fortune Brands Innovations has to positively impact lives and communities.

Our purpose is to elevate every life by transforming spaces into havens. This represents a bold, multi-decade vision for the company where through our products, we can impact the lives of our customers, our associates and our communities. We will bring our purpose to life by executing upon a specific set of behaviors and strategic drivers.

Grounding our business in an authentic, clearly articulated purpose, unique set of strategic drivers and expected behaviors will help unlock higher levels of innovation, increased employee engagement and retention and transformative growth.

Teams across the globe made a unified effort to ensure that every one of our 11,000 associates had an opportunity to discuss our purpose, behaviors and drivers, helping to underscore each associate's connection to how they can make an impact.

As the market improves, the work that we have done to enhance our already strong culture will accelerate our opportunities for growth. We've continued to refine the organization, including recently reducing inefficiencies, while continuing to invest in key strategic priorities. Our more efficient structure has allowed us to make strategic decisions faster and with more precision and deploy our Fortune Brands advantage capabilities across the portfolio. As we have often noted, this is a multi-year journey, but one which is already showing concrete results.

Turning now to segment results. Starting with Water Innovations, sales declined 8%, while operating margin improved 40 basis points versus last year. Excluding China, organic sales were down 2%. We are

managing the business tightly, while continuing to make key investments in our most critical priorities like brand, innovation and digital.

Our Moen North American business delivered organic sales, down low-single digits. Our brand metrics remain strong, with Moen being number one for unaided brand awareness and the most trusted brand. Our whole home water performance showed significant share gains.

As I mentioned earlier, Flo continues to gain traction with insurance companies, municipalities and consumers as the leader in this emerging space. We are finding new use cases, every day, for this ecosystem of products.

While the new insurance and municipality partnerships are continuing to ramp up, our retail and e-commerce point-of-sale accelerated 80% in the third quarter, highlighting the continued adoption by consumers. We expect sales of our Digital Water business to accelerate through 2024 and throughout 2025.

Turning to our Luxury business, organic sales were down low-single digits in House of Rohl, which now includes Emtek. We're now one year into our acquisition of Emtek and the work to integrate the brand into our comprehensive and complementary luxury portfolio, including in showrooms, is progressing very well. And the feedback that we have received around our combined portfolio has been very encouraging. We will have installed over 150 Emtek displays in existing House of Rohl showrooms by the end of the year, and we expect this expansion effort will continue as we head into 2025.

Finally, China sales were down more than 40% this quarter, as the Chinese consumer remains cautious and the real estate market remains soft. The government has recently announced policies designed to spur investments in growth, but it is too early to know the magnitude or timing of impact. In the meantime, the team continues to tightly manage costs and cash flow, through the current conditions. Given the magnitude of the decline in China, the business now presents very little bottom line risk and is a nice option for future growth when the market returns.

Looking to the remainder of 2024 and into 2025, our Water segment will focus on those parts of the market with the greatest potential for growth through our leadership in brands, innovation and channel. We continue to expect our relationships with the large national builders to benefit us, and we believe new innovative product offerings will further distinguish us from our competition, across our channels.

And of course, our Smart Water network, including our ecosystem of leak detection products, should offer us attractive growth opportunities. We will continue to make thoughtful investments in our key priorities, including core branding and digital initiatives. We also see future fuel for growth opportunities as we leverage our Fortune Brands advantage capabilities to optimize our operations and supply chains and leverage our channel pricing expertise.

We remain very excited about our water business, particularly the opportunities we see to capture outsized growth.

Turning to Outdoors, sales are down 6%, with strong results in our doors business, offset by destocking in the wholesale decking channel. Importantly, our margins were 18%, an impressive 320 basis points above prior year. We continue to focus on leveraging our expertise and investing behind our core categories and in those areas which we expect will offer the most attractive growth opportunities.

Our door sales were flat as tailwinds from new construction and recent retail wins drove sales, and we continue to take share in fiberglass. Therma-Tru continues to see the benefit of the increase in starts and completions, which began last year, and Larson is seeing nice performance driven by recent innovation launches, which we believe will further accelerate.

Decking sales were down more than 30% in the quarter due to inventory actions in the wholesale channel and a slower demand market. Importantly, our point of sale in the quarter was down mid-single digits. We believe the results in our Fiberon business reflect onetime destocking impacts from a decking season, which was softer than expected and which are now behind us.

Looking forward to the remainder of 2024 and into 2025, we expect to continue to leverage our strength in our wholesale channel, as well as our expertise in innovative materials. We will continue to benefit from our strong relationships with large builders in our Therma-Tru business. Additionally, recent product resets should drive accelerated performance in retail. We are focused on outgrowing the attractive outdoors market, across our brands.

Finally, turning to our Security business. Sales declined 14% in the quarter, and organic sales were down 12%, while our point of sale was down mid-single digits. Results were primarily due to market softness, destocking and consumer trade down on the digital shelf as the number of inferior and non-compliant private label alternatives has, unfortunately, proliferated. We are taking definitive action to reverse this trend.

Our brands are incredibly strong, and we are responding by helping consumers understand the value proposition of our trusted brands.

For example, we recently launched a compelling new ad campaign, which highlights the fact that our fire safes keep documents protected from natural disasters like wildfires and floods, while many imposter brands failed to do so. We are already seeing positive momentum in our point of sale.

Finally, we've increased our promotional cadence to better meet the market. Importantly, this segment also saw a 250 basis points of operating margin improvement as our continuous improvement activities, supply chain optimizations and cost controls resulted in expanding margins. The significant cost work that we have done on these brands over the past two years is allowing us to invest in marketing, innovation and promotions, all while growing our margins.

A year into the acquisition of Yale and August, we are utilizing their team's skills and knowledge throughout the business, and their expertise is being deployed across our portfolio as we continue to accelerate our digital strategies.

Looking to the remainder of 2024 and into 2025, we will continue evolving the security business by focusing on our strong brands, opportunities for differentiating innovation and by reinvesting some of the efficiencies gained from our recent optimization of the business to strengthen our already iconic core brands and add meaningful innovation to our products, including our exciting digital products. We are proud of how our business is helping people and companies across the world protect the things that matter most.

As we finish up 2024 and turn to 2025, our teams continue to navigate near-term challenges, while executing multiple initiatives to drive our long-term success. We will continue to strategically manage the business in light of the uneven market backdrop, focusing on those areas where we have the greatest potential for above market growth, continuing to make key investments and also looking to manage our margins.

By taking these decisive actions now, I believe we will be best positioned for accelerated growth, when the external market conditions improve.

I will now turn the call over to Dave.

**David Barry**

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

Let me start with our third quarter results. As Nick highlighted, our results reflect our focused execution on a tight set of priorities amidst a challenging external market. Sales were \$1.2 billion, down 8% and excluding the impact of China, organic sales were down 5%.

Consolidated operating income was \$216 million, down 2%. Total company operating margin improved to 18.7% and earnings per share were \$1.16, down 3%. Free cash flow in the quarter was \$176 million, which brings our year-to-date free cash flow generation to \$262 million.

Turning to sales. Net sales results were driven by China softness, low single-digit POS declines and inventory reductions in outdoors and security. Our operating margin of 18.7%, a 130 basis point improvement, reflects our team's focus on a narrower set of priorities and our ability to drive continuous improvement savings, offset by our investment in our strategic initiatives, which we are confident will result in growth as the end markets improve.

Our team's execution resulted in decremental operating leverage of 4% in a sales environment that was softer than expected.

As I will detail later, our balance sheet remains strong, and we have the flexibility to manage 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 \$635 million, down 8%. Excluding the impact of China, organic sales were down 2%. The organic net sales results reflect the impact of lower volumes amid a softer market. Water Innovations operating income was \$156 million and operating margin remained strong at 24.6%, reflecting lower volumes, partially offset by continuous improvement initiatives. Both Moen North America and House of Rohl POS were down low single digits.



China sales declined over 40%. The Chinese market remains soft and while encouraging policies were recently announced to bolster the market, it is too early to predict a recovery. That said, the team continues to focus on re-platforming the business, while preserving growth optionality.

Turning to Outdoors. Sales were \$343 million, down 6%. The sales reflect low single-digit POS and a mid-single-digit channel inventory reduction in the wholesale decking channel. Segment operating income was \$62 million, up 13%. Operating margins for the third quarter were 18%, an improvement of 320 basis points.

Door sales were flat. Sales were positively impacted by higher volumes from single-family new construction, offset by continued R&R softness. In decking, we saw sales decrease by over 30% in the quarter, driven by channel destocking. Importantly, POS was down mid-single digits in the quarter.

Inventory levels remain low, and we expect this quarter to be an abnormal result with evidence of improving trends, as we begin the fourth quarter.

Finally, in Security, sales decreased 14% to \$178 million, or down 12% on an organic basis because of a softer market and the impact of lower quality import brands. Total Security segment operating income was \$34 million, down 1% while operating margin was 19.3%, an increase of 250 basis points, as actions we took over the past few years continue to benefit our results.

Looking forward, we will invest in our brands and in product and software innovation to further position ourselves as the leader in the mechanical and digital security space.

Turning to the balance sheet and our cash flow performance. Our balance sheet remains strong with cash of \$345 million, net debt of \$2.4 billion and net debt-to-EBITDA leverage at 2.5x. We repurchased \$35 million of shares in the quarter and have repurchased \$190 million of shares, year-to-date. We continue to focus on generating cash, and we'll remain opportunistic and returns-focused around our share repurchase strategy, while also being mindful of our leverage ratio, which are trending as expected.

To summarize the quarter, we focused on executing our priorities for long-term growth, while delivering strong margin results in a soft environment. Our margin results reflect our commitment to productivity as well, as the impact of actions we took to further align the organization around our strategic focus areas.

With that in mind, I'll now provide an update to our 2024 guidance. As today's press release indicates, we are revising our full year guidance. This change accounts for several variables, including a choppy demand market, short-term impacts in hurricane-affected regions and lower channel inventory, partially offset by continued strength of digital water. Importantly, it also reflects our commitment to maintaining investment in key priorities that we expect will generate future growth.

Our revised EPS guidance is now \$4.17 to \$4.23. We continue to have full confidence in our long-term strategy around our core and digital products.

Regarding the impact of the hurricanes, we see the impact most acutely in our Moen and Doors businesses, with POS in impacted states down more than 25% since the hurricane. We expect that single-family new construction will see an outsized impact as labor is redirected towards storm cleanup in the

near term. However, we expect these orders to more than recover, as operations normalize and communities rebuild. The full details of our updated guidance can be found in our press release.

As we head into 2025, we are actively planning for a variety of scenarios around the inflection in the demand environment. While it is impossible to predict the exact timing of this inflection, we continue to believe it is a matter of when, not if, and when the demand inflects, we will be uniquely positioned for outperformance. While we will not provide guidance assumptions for 2025 at this point, we are able to share some initial thoughts.

Our initial planning assumptions include a market with slightly positive growth. We expect this growth will be weighted toward the second half of 2025, and we expect above-market performance, accelerating from both our core and digital products, driven by the initiatives underway. We also expect to make meaningful margin progress and deliver strong EPS growth in this scenario.

Our teams have done a nice job navigating the uncertainty of the past few years. And as we approach the end of 2024, we remain confident about the future of the business and our team's ability to create value. We are focusing on controlling what we can control and continuing to pursue our long-term strategy.

I will now pass the call back to Leigh for Q&A. Leigh.

**Leigh Avsec**

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

I will now turn the call back to the operator to begin the question-and-answer session. Thank you.

**Operator**

If you would like to ask a question at this time, please press "\*", then the number "1" on your telephone keypad. Once again, to ask a question at this time, press "\*", then the number "1" on your telephone keypad.

Our first question comes from John Lovallo with UBS. Your line is open.

**John Lovallo**

Hey guys, thank you for taking my questions. A lot of information here, so hoping--hopefully, you can help us unpack some of this. So starting at the top, you lowered the consolidated sales growth for the full-year from a positive 2.5 to 4.5 to down--or sorry, to flat to plus 1 and then lowered the organic sales outlook from down 1 to down 3, to down 1.5 to down 3.5, and the downward revisions were across segments.

In terms of the third quarter, it looks like results were below expectations, across segments. It sounds like the operating environment certainly got more challenging. But I was hoping you can just kind of help us better unpack some of the moving pieces in the quarter and in the outlook. I mean, how much of the decline is from the third quarter being softer versus expected fourth quarter slowing versus storm impact, things of that nature?

**Nick Fink**

Hi, John, this is Nick. I'll try to break it down for you, as best I can. So, if I think about it, (inaudible) sales reported an outlook or organic, excluding China because that's all of the thing was down 5. Within that point-of-sale, excluding China, was down low-single-digits. So you start to dial it in a little bit. And certainly, I take consumer was weaker in the quarter than we thought they were, particularly in the middle of the summer, July or August. It was particularly slow. I think we saw it across consumer company, saw some recovery towards the end of the quarter.

But if I look at our performance in particular, I really see three things at play. One, we've deliberately pivoted away from some of the low-margin and commoditized business in favor of focusing on our supercharge categories. And while we did that, two, we worked and did exceed our own expectations on the digital side, but we need to convert those contracts to revenue, faster.

And to do that, we need to rate capacity even faster than we thought. And that's just a question of throughput. We've signed a deal. They're in the pipeline but it's a space we're learning. And just like mechanical products, you've got to go build the factory in order to produce it, and we realize we need to ramp that capacity, faster than we thought. And so those are in the pipeline that didn't materialize in the reported results for the quarter.

And then the third thing I would call out that is a marketplace dynamic is we are seeing some trade down to knock off imposter brands, not so much a regular private label, which you'd expect to bring generally important brands are making false claims about safety and performance that we're going to come back. And as I described, we're already doing some of that.

We have some of that in play. We've got more of it in the pipeline. But where we've done it, we're already seeing the point-of-sale start to reaccelerate as we're doing a better job explaining our consumers what the difference is and what the brand premium is worth.

And so that sort of leaves me confident as I kind of pull it all together, that while it was a bit softer, and we also had some stuff moving away from us, while a lot of good news coming our way, we just need to convert that to sales, even faster.

**Dave Barry**

Yeah, and John, I'd add a couple of things and I'll unpack guidance a little bit. But before I do that, what's also evident is the team's focus on margin. And as we re-platformed the business and stepped away from some of the lower-margin categories where brands and innovation don't matter as much. You see that even though sales were softer, we're delivering very strong margin results, 4% decremental in a quarter that was softer than we anticipated, up 130 basis points in operating margin year-over-year and 110 year-to-date. So the margin is still coming through; the story we expect to continue.

And then on the guidance, you're right to point out the consolidated change. I'd say that's roughly 3 percentage points lower for the year at the midpoint, which call it \$135 million or so, 80 of that came through in the third quarter, which leaves about 55 then in the fourth. And of that in the fourth, about half is hurricane related, about half is continued consumer POS softness that we're working to combat.

That said, as we look at the fourth quarter, it still leaves us in a spot where sales are down low-single-digits. We have operating margin improvement of 100 basis points, maybe a bit better than that and high single to low-double-digit EPS. And so EPS growth. And so, while not as good as we may have thought 30 days ago, still a pretty good quarter, just not as robust from the consumer as we were hoping, heading in the back half of the year.

**John Lovallo**

That's helpful. And then maybe focusing in on some of the margin improvements. I mean, in outdoors, sales were down 6.5%, year-over-year. Margins were up, I think, over 300 basis points. Security was down, I think, 14% for sales and op margins were up 250 basis points. And even on a sequential basis, sales were down and margins were up. I mean--so what kind of drove the margin strength in those two segments, both sequentially and year-over-year?

**Dave Barry**

Yes, and outdoor is a combination of doors, Therma-Tru door volumes being better year-over-year and volume even in Larson and storm doors being better year-over-year. And then in decking, some of the work we've done to shed some of the lower profitable business that we had. And we've talked about in the past, we exited a window supply agreement for window components. We've looked hard at our kind of sourcing and manufacturing around PE and PVC decking to make sure we're driving continuous improvement productivity there.

And so a lot of internal initiatives to really drive the margin in outdoors plus some volume coming through on the door side.

And then in Security, we talked about the actions we took earlier this year to drive the cost savings by altering our footprint. I mean, that's really coming through now. And we'd expect that to continue to be a tailwind into 2025. And to Nick's point, this is an area where we are investing back in the business. We're investing in innovation that will come to market, next year. We're investing in marketing campaigns for the first time in a while for these brands that will come to market, now and into next year. And it's all really to combat some challenges on the shelf from the import brand.

**John Lovallo**

Understood, thank you, guys.

**Operator**

Your next question comes from Phil Ng with Jefferies. Your line is open.

**Philip Ng**

Hey guys. Dave, thanks for giving us a framework for '25. I fully appreciate that guidance per se. Frankly, I thought the back half '24 is not that bad. I mean, if you flush out some noise, it sounds like organic sales are down low-single-digits, 1% or so. So when we kind of look out to '25, you said slight growth in the market and usually grow a little faster than the market by a few points. Are we kind of talking about, call it, low to mid-single-digit organic growth and little more muted in the first half and you see better growth? And then help us kind of think through the levers you have at play in terms of the margin side of things for next year, as well.

**Dave Barry**

Yeah, it's a great question. It's tough for us to pinpoint right now and still a lot of uncertainty. When you've seen what happened with bond markets over the past month, that's going to lead to higher mortgage rates on the flip side. We expect the prime rate to continue to come down, which is going to lead to some affordability benefits around refinances and HELOCs and home equity loans and just everyday borrowing. So it's tough for us to say.

I would say we see the outperformance really driven in two areas. So one, improving core category POS based on the actions that we're taking now. And then two, as we talked about conversion of the connected pipeline into sales. And so, I would expect our outperformance to accelerate through the year as both of those things come through the P&L, but hard to say kind of what that level is, based on the underlying market, at this point.

**Philip Ng**

Okay, that's helpful.

**Nick Fink**

And as we get to '25 guidance, I think we'll have another 90 days of converting that connected stickiness in Flo contracts into sales, and we'll have a better sense. I mean, just to be very candid, it kind of caught us both by surprise, the pace at which we were able to ramp that business. We now have, as I said, 8 million policyholders under contract. At only a 5% conversion rate, it's \$160 million of sales we have in the pipeline. So what we're learning is you got--so our website, you got to book collateral. You've got to get these things activated in market. And I think as we get a better sense of how quickly we're able to do that, we'll be able to dimension market outperformance that we expect.

The fact that we have another 60 million policyholders under discussion right now, at least a portion of which will convert the contract, we think it's going to go as a great pipeline into next year.

**Philip Ng**

Okay. That's helpful. Actually, that was my--that's a perfect segue, Nick. On connected products, if I remember correctly, last quarter, you were calling for maybe 2 points of incremental growth in the fourth quarter. How are you kind of shaping up in 3Q, 4Q? And then as we look out to '25, it sounds like a high-class problem to have. There's really strong demand, and you've got some natural bottlenecks here. How do you unlock that supply? Are you actually building facilities? Are you going through third-party partners? Help size of that opportunity perhaps in '25 and how that capacity unlock will like shape up next year.

**Nick Fink**

Yeah, I'll start with the second part of your question, and Dave can dimensionalize the sales piece of what we expect. But think about it like--you might think about building a factory, but just in the virtual world, and that's exactly what we're learning. Like you have--there are certainly the ideators, not there a lot of our team work on the charge of engineers. They're production people, they're helping produce the product or the software, firmware, sites, the things that you need to actually make that sale.

And that, we need to do a great job of ramping even faster than we have. Now, you know the history that started almost at 0 in '21, and we're now investing very heavily Dave will dimensionalize for you, if you like, behind our digital opportunity, and we've done that while delivering this margin expansion.

So we're super excited that we've been able to build this engine because it's been a little while in for us that we probably have to build it even faster, and so that is growing investment where the growth in the business is and really just invest in the people. You've got sort of an onshore, offshore; it's a combination. I mean you really need the leaders and the thinkers and the architects are part of our organization. A lot of those people came across with the August acquisition; they're fabulous.

But then we're also going to leverage outside help or offshore parties that might be really steeped in just a particular part of digital piece of the puzzle that you need to deliver. And so we call that there. But myself and my executive team have really been focused over the last 90 days on just how do we put the capability and capacity to ramp this even quicker.

**Dave Barry**

And on the financials, Phil, I'd say, if we look at the pipeline and POS activity ahead of expectations, if we look at how that's converting into sales, it's a bit behind where we were a quarter ago. And to Nick's point, that's where we're trying to ramp up some targeted investment to unlock those sales. But I feel really good about the opportunity is still there and growing as we're working hard to convert to sale.

And then we had a little bit of inventory come out of the Yale channel that the other headwind under the sales number, but I feel like that it's a onetime event that we'll be through by the end of the year and really focus on getting this pipeline through and converting into sales in '25.

**Philip Ng**

Okay, Exciting, really appreciate the color, guys.

**Nick Fink**

A little bit more around that. The way to think about it today probably sign an agreement, taking us two to three months. We want to be in the two to three week range. That's the goal.

**Philip Ng**

Okay, thank you.

**Operator**

Your next question comes from Mike Dahl with RBC Capital Markets. Your line is open.

**Mike Dahl**

Thanks for taking my questions. I just--starting with that, I want to make sure we're clear with kind of the terminology on Flo. When you're talking about the pipeline and you're talking about the \$160 million in sales and assuming 5% conversion, is that the actual agreements you have in place? Or this is still an estimate that you're using for a conversion rate based on just the number of insurance policies that you have coverage for right now?

**Nick Fink**

Yes. I'll dimensionalize a little bit for you. I'd say broad line, it's an estimate. There are three--probably three types of agreements we sign. Various types of agreements where the product may be recommended and offered. There is the type of agreement where the product is offered with a rebate, and then there's a

type of agreement where it's actually mandated where the insurer will say to the policyholder, unless you put this in, you will get no more insurance from us.

Now even in the third bucket where it's mandated, it's not an instant off. I mean you could imagine what would happen publicly if they just turn polices up. So they give that homeowner some time to comply with the mandate. But those are the three types of contracts we're currently out and executing in the marketplace. What we did to get to \$160 million was saying, well, we took a mere 5% conversion rate. That would be \$160 million on the contracts we've already signed.

Now I will tell you, we expect a far, far higher conversion rate with the mandated contract. Those will go in at, it should be 100% minus whatever policyholders choose to walk away. So these are not markets very easy for you to walk away from your insurance because there's not a lot who have insurance. Some of the places where it might be recommended, they pay back for itself with a discount and that's a lower conversion rate. We felt 5% is very conservative, but that's how we get to the number of what we've already signed.

#### **Mike Dahl**

That's really helpful, Nick. And if I could just point of clarification and then a second question, a point of clarification would be that 5%. Do you work with your partners on, hey, this is kind of when we've done other things for other parts of insurance policies where you're having to lock in, whether it's like alarm monitoring or whatever, like this is kind of the conversion rate we think about or what informs that?

And then the second separate question just in the spirit of this week's events. Can you remind us, there's been a lot of moving pieces in your portfolio and your sourcing initiatives. What is your current cost of goods exposure to China? And then what's your total cost of goods exposure that's outside of the U.S. that brought onshore at this point?

#### **Nick Fink**

So just on the--on your first question, we use very, very precise models with insurers to understand, A, what the effect of savings will be. I will tell you, they are pretty eye watering when you do the numbers, multiplied by the number policies they have. And then B, from there we work on an expected conversion rate in the period of the supply chain, accordingly. The 5% is quite a bit lower than that. That's our conservative assumption. That's not what we are actually gearing a supply chain and these contacts; we're gearing them to do something in excess of that. So that's the first part.

The second part, I'll just give you a general concept to think about and then Dave can add to that a little bit, the sourcing piece spend. I will tell you that we have been in the mode of optimizing the supply chain and managing tariffs really all the way back to fiber tariffs in 2017. The team is extremely experienced in this area. One of the things that I would say has evolved pretty significantly is our ability to flex that supply chain.

And so, we've moved away almost everywhere from a single source. We now have two sources, and your secondary source may cost you a bit more than your primary source. But if your primary source were to become more expensive because of tariffs, you can dial that down and dial up your secondary source and rebalance it to be the most efficient.

Of course, added to that, we still have a very large U.S. manufacturing footprint that becomes part of that total network solution, not just an independent thing. It's the role that it plays in that total network solution. So I'm confident that we are very well positioned, it'll increase tariffs. I'll tell you, we don't divide it, because it's a lot of hard work. But every time it happens, our share tends to accelerate because of our ability to execute relative to the competition. And that's where we really put the emphasis.

And a final thought before I hand it to Dave is we do have a smart team against this that have been working on this for many months and run up to I guess in today with the expectation that we will see tariffs. I think the TBD may be exactly where you see them and to what degree. But with the network that I've described, we're well prepared.

**Dave Barry**

Yeah, and the impact, Mike, I'd say, going back to 2018 and look at these set of assets, we had over 50% of our COGS sourced from China, that's down to less than 25%, today. The next point, the team has been working against that. For while the tariffs are still in place, we're still paying. The more tariffs we can get out of China, the better.

Looking broadly at our COGS, I'd say U.S. is roughly 40% to 50% of the COGS base. If you remember, Outdoor is almost fully U.S. Water has a big piece in the U.S. and then Security has a piece in the U.S. So you take that add, a little business in China, the balance being Rest of World and a portion of that Rest of World is North American based. And so--but we do have options. We're operating under a base case scenario that tariffs from China, at least are going to increase, and the team is working to optimize our network around that. And we do view this as an opportunity.

**Mike Dahl**

That's very helpful.

**Nick Fink**

I just refer to the session we had around John's question. I'll just end on that third point. We have seen in the market a bunch of import brands they claim to perform whether it be in security, in fire safes, in water safety, at levels that our own testing demonstrates they do not deliver. That is something that you'll see us increasingly ramp up our communications around. Some of it is directly to people's while being in health and safety. I don't think that increased focus on some of that product that we've seen coming into the marketplace and that's really a good pathway.

**Mike Dahl**

Yeah, make sense. Thank you.

**Operator**

Your next question comes from Trevor Allinson with Wolfe Research. Your line is open.

**Trevor Allinson**

Hey, good evening. Thank you for taking my questions. Nick, I wanted to follow-up on what you were just referring to with some of that non-complaint product competition. Can you just dive into that a bit further, talk about how big of an impact that had on the quarter? Is that something that you expect to linger here, going forward? I know you talked about some initiatives that you're going through to mitigate some of that. But just any way you can size that for us would be helpful.



**Nick Fink**

I'll give you a few examples, just to start off. First kind of start on the fire safe, so we're paying this via fire safes. And our waterproof safes and consumers really depend on that, particularly in the fire zone or hurricane zone. We see--you can all do your own research, you'll see products in the market that claims similar performance. We put it through our own testing. And we're--our safes will withstand a fire. Most of these import brands burn within two minutes.

We put collateral out into the marketplace, that is the first one. We tested it and we put collateral that into the marketplace and investment behind telling the story, and we are seeing our point-of-sale turn around and start to gain--actually gain share, very quickly, really within weeks of activation. So it gives us confidence that when we tell the story, the consumer sees the value in it. We've now extended some of that work to things facets. We're finding their facets have reached less into the waterway; that is not legal. We will tell that story and so on and so forth. We have started on connected security.

So, there is no doubt on an opportunity. I wouldn't say the impact was massive. But unlike regular way private label, where we don't really compete at opening price point, and we've done just fine because people see the value paying for the premium for the brands, and we strategically position our portfolio like that. These are places where people are advertising in a misleading way that is directly competitive, because they're claiming the same benefits as our brands provide at a lower price than they actually are not providing them.

And so again, we tell the story, it seems to change this trajectory. We're just now making the investments, and taking the time to do that, and we'll be doing it more publicly as we move forward.

**Dave Barry**

And Trevor, you see this both acutely in our organic security results, year-to-date. This is where most of the problem is showing up and where the team and Nick are trying to take action to offset it.

**Trevor Allinson**

Okay. It makes a lot of sense. I appreciate that color. And then the second question is on China. Conditions there are clearly dynamic. Nick, I think you used the word unprecedented, so a lot of uncertainty there. Can you talk about how you're thinking about that market moving forward? Do you think you're nearing a bottom here? I mean, comps are clearly getting a lot easier. Any color there would be greatly appreciated? Thanks.

**Nick Fink**

Yeah, firstly, I'd say your question is highly logical. You would think one is nearing a bottom, just given how long it's gone on, how much less of new construction there has been, as well as the fact that the government does seem committed to creating that bottom and stimulating that marketplace.

That said, I will say, after a couple of years in this, we just feel like we can't think on that. The team here has done a fabulous job managing the cost structure and the P&L where that is still a profitable business for us.

And so, the way we think about it as long as we can keep it, isolate it and manage it in that way. And frankly, when I look at the size of the profit pool today, it's really could go to zero, and wouldn't have a noticeable impact on the total company. It really is a market that should give us exposure to growth and grow returns, and the demographics will tell you growth has to return at some point.

And also, it's a really nice innovation engine for the business. We have a great team there that is very, very close to a lot of great innovation in that service on the pipeline from the whole business. And so, that's really with a lot of humility to the team over there have done a great job in how we're thinking about it and how we're managing it. When that bottom actually forms, that would lose money making that prediction. So we'll just manage it tightly, in the interim.

**Trevor Allinson**

Yeah, I would, too. I appreciate all the color. Thanks.

**Operator**

Your next question comes from Stephen Kim with Evercore ISI. Your line is open.

**Stephen Kim**

Yeah, thanks very much, guys. Appreciate all the color, so far. I wanted to ask you, in security, I think you had mentioned that POS was down mid-single digits, but you're guiding to sales down, I think high-single digits, if I'm not mistaken in the fourth quarter. I was just curious if you could sort of talk about that?

**Dave Barry**

Yeah, happy to. The guide implied sales down mid-to-high single digits in the fourth quarter, that's right. And I'd say it's continued consumer POS softness. And as I said we are starting to see some of the trends churn based on the investments we made, but those investments came late third quarter into the beginning of the fourth quarter. And so, not ready to predict a complete turnaround yet on that POS trend.

**Stephen Kim**

Got it. Okay. But maybe the outlook into '25 might be better, hopefully. And then to sort of follow on these low-quality competition, low-quality competitive products you're dealing with in digital security. I just wanted to get a sense, is this issue more pronounced in--maybe in the online channel, or is it--are you seeing it pretty much across the retail--across all retail, including online? And can you share with us like what share of your digital products are sold online?

**Nick Fink**

Why don't I start. And again, just to reiterate, I still have a problem where they're lower quality. Like we are just certainly not competing at that bottom end of the channel. It's where they're making false claims that we are combating and combating with success. And so that is where we saw this issue sort of emerge very quickly. And yes, you're absolutely right. It's much more prevalent in the online space where you've got the institutional. And there's probably less scrutiny around product claims that are put on web pages. And in terms of breaking out the percentage, Dave.

**Dave Barry**

Yeah, I would just say, Stephen, it definitely over-indexes our mechanical channel breakdown. The digital products more have to be purchased online, at least today as we build out the other channel.

**Stephen Kim**

Okay. Thanks very much guys.

**Operator**

Your next question comes from Adam Baumgarten with Zelman. Your line is open.

**Adam Baumgarten**

Hey, good evening guys. Just back to the digital, I think you talked about 150 basis points of growth contribution in the back half of '24, last quarter. Maybe if you could update that number and maybe what it was in the third quarter?

**Dave Barry**

Yeah, we talked about that a little bit earlier. So I'd say our POS and our pipeline is exceeding expectations. The sales number coming through is a bit below that, just given our conversion rate from the pipeline into sales, and we're investing to trying to unlock that. As Nick mentioned, taking that time to revenue from three months down to three weeks is really the goal. Third quarter, similar, I'd say POS very strong. It's up over 80%, signing new agreements, we just have to get them into revenue.

**Adam Baumgarten**

Okay. Got it. And then just--you mentioned trade down, I think, in security or maybe some of the positive products. Are you seeing trade down across any other areas, like outdoors and water?

**Nick Fink**

No, not across outdoors and yes, a bit in water and again, it's not so much a trade down just upping price points. I want to be really clear. That's always been around. It's where we've seen false claims that we've seen the impact in water, we've seen a bit, and we've got some of those products in testing and not just false claims, they're non-compliant. And so, we're confident in the process to work back against that.

**Adam Baumgarten**

But in the non-connected products, you're not seeing any material trade down?

**Nick Fink**

We're not--actually, I'm not talking about connected products at all; I want to be clear. It's not really in--it's really in mechanical things like fire safes, kitchen faucets, some in the padlock space. It's really mechanical product that just coming in sort of looks the same, makes a whole bunch of claims, doesn't perform where they claim.

**Adam Baumgarten**

Got it. That's helpful.

**Operator**

Your next question comes from Matt Bouley with Barclays. Your line is open.

**Matt Bouley**

Good afternoon, everyone. Thanks for taking the questions. I think you made a comment in the prepared remarks around 2025 with that slightly positive market growth and that you would outgrow that. That in that scenario, you would see meaningful margin progress, I think I heard you say. And so, given your outgrowth that maybe you're seeing a little bit of volume leverage. But I guess what are the other pieces of the bridge that might get us to meaningful margin progress? And how do you think about incremental margins in a scenario where the market would be slightly positive? Thank you.

**Dave Barry**

I'll give you a bit of color and context, Matt. I'd say we see margin next year coming from a few areas, right? So productivity, we've had a very nice trajectory. SG&A efficiency as we continue to bring the businesses together that we're finding more SG&A efficiency, and then mix, we expect to be favorable.

I think price cost will probably be a slight benefit, as well. The offset and why we're not being more specific right now is the level of investment back in the business. When we talk to guidance, we'll be clear about where and how we're reinvesting, primarily around unlocking growth and setting it up for future growth opportunities. So that's the big offset lever right now. The teams are still working through. And Nick and I look at the decision to make how much are we going to invest back in and how quickly could we turn that into growth at the top line.

**Matt Bouley**

Got it. Okay. Thanks for that Dave. And then secondly, on the decking business, I think I heard you say you were seeing some evidence of improving trends to enter the fourth quarter and something around destocking, if you guys were talking about it potentially being onetime. Just maybe hit on both of those points. Just have you seen the destocking subside, or is there any more to come? And what are you seeing around some of these improving trends here? Thank you.

**Dave Barry**

The destocking, I think the channel loaded up for a season that was disappointing, and so that came out. That was really primarily the driver of the destocking. On the POS side, we were down mid-single in the quarter. As we've looked over the past four weeks, it has improved from there from a POS standpoint, which gives us confidence that improving out of where we were in Q3.

**Matt Bouley**

Okay. Thanks Dave. Good luck guys.

**Nick Fink**

Thanks.

**Dave Barry**

Thanks.

**Operator**

Thank you for joining.