Fortune Brands Innovations, Inc.
Third Quarter 2026 Earnings Conference Call
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Presenters
Curt Worthington, Vice President, Finance and Investor Relations
Jesse Singh, Chief Executive Officer
Pete Clifford, Chief Financial Officer

Q&A Participants
Keith Hughes - Truist Securities
Ketan Mamtora - BMO Capital Markets
Phil Ng - Jefferies
Michael Rehaut - Melius
Susan Maklari - Goldman Sachs
Mike Dahl - RBC Capital Markets
Sam Reid - Wells Fargo

Operator
Greetings and welcome to the Fortune Brands Third 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, please press star zero on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce Curt Worthington, Vice President of Finance and Investor Relations. Please go ahead.

Curt Worthington
Good afternoon, everyone, and welcome to the Fortune Brands Innovations Third 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 Chief Executive Officer, and Pete Clifford, our new 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've now completed my first full quarter as CEO, and I'd like to thank the Fortune Brands team for their hard work through a period of significant change. Over the last 90 days, I've spent time with our customers and our teams digging into our execution challenges. While there is clearly work to do, what I've seen thus far has reinforced why I joined Fortune Brands. We have exceptional core brands. Moen, House of Rohl, Therma-Tru, Larson, Master Lock, and Yale are brands that consumers and pros know and trust with market positions built over decades that are extremely difficult to replicate. Because of our focus as a product-driven company, we have continued to maintain a strong portfolio of products, and each of our businesses has a robust downstream sales force and new product launches that are differentiated and well received by our customers. That is a strong foundation to build from.

I've also seen firsthand the level of engagement by the key decision-makers at our customers and channel partners. Our brands matter to their businesses, and when we perform, they perform. Our customers have been clear about what they need from us, reliable service levels, closer collaboration, stronger marketing, and accelerated product development. The good news is that achieving those expectations is within our control, and we have a path forward with customers and channel partners who are invested in the outcome. I also see a clear opportunity to run each of our market-leading businesses better. Through our deep dives, we have identified growth, operational and portfolio actions that, as we execute them, will meaningfully improve our results.

Third quarter results, excluding tariff and tax benefits, were in line with our August outlook and mixed by business. In water, our performance was impacted by our exposure to new construction, which softened further during the quarter. Outside of service challenges, our outdoors & security businesses have generally performed in line with the market. In outdoors, our doors business continues to be resilient, and we expect Therma-Tru to benefit from the positive outcome of the recent antidumping case. While Therma-Tru continues to offset inflation through continuous improvement, margins have compressed, and we expect to take some pricing actions, balancing price and share. At Larson, higher aluminum and freight costs have driven significant commodity inflation, which has pressured our margins. We have actions underway to return to a more favorable price/cost position.

In security, I'm encouraged by the traction of this year's new product launches, which continue to build momentum during the quarter. That momentum was partially offset by limited product availability in Yale as we prioritize service levels for our contracted business. As stated on our last earnings call, real long-term value creation will take time, and this will be a multiyear journey with milestones and progress along the way. Over the coming quarters, we will continue to highlight key milestones and provide more specifics on our long-term strategy and growth

profile. Today, I'll focus on where we are on this journey and how our recent actions will translate into our results in the future. Our back-to-business plan is designed to restore consistent performance and long-term shareholder value. A graphic describing the back-to-business plan has been included in our earnings presentation.

The plan is organized around four main pillars: establishing high-performing customer-focused business units, optimizing our portfolio across and within those business units, building a business-led sustainable growth engine, and expanding margins while sustaining our growth investments. In our first pillar, we are unwinding much of the centralization of the last few years and realigning our functions to create more entrepreneurial business segments. We have had unnecessary complexity and inconsistency that has impacted our speed, our innovation, and our ability to consistently deliver high-quality service to our customers.

Moving to a more focused organization will allow us to improve our execution and the productivity of our SG&A. By the end of this quarter, we will have completed the realignment of most of our salaried employees to be focused on specific business units. Earlier this year, roughly 40% of those employees were aligned to a specific business or a specific geography. By the end of this year, that number will be above 80%. Key short-term milestone of these changes is to improve our service and responsiveness to our customers. Our supply chain team has brought back key people to help restore the institutional knowledge, systems know-how, and product level expertise we lost during our headquarters consolidation. We are also rebuilding our sales and operations planning process and restoring safety stock to appropriate levels.

As we said last quarter, we expected some pressure on volumes and a higher cost to serve our customers in the near term as the team puts these actions into place. Service levels in the past quarter improved 10 percentage points with fill rates reaching the high 90s range entering Q4. While I am encouraged by this progress, our focus now is on consistently delivering those levels in a cost-effective manner. We have also made changes to our leadership team to create greater focus and enable future growth. Dave Barry is now leading Moen as EVP and President, and Rachel Roberts has become Chief Commercial Officer for Moen. In our luxury portfolio, House of Rohl will continue to be led by Matt Zimmer, who now reports directly to me. We have also made changes across all of our businesses including a new sales leader at Moen, a new General Manager for doors, and a strong executive added back to security.

In addition, we recently announced the appointment of Peter DuBois as EVP and Chief Information Officer, bringing more than 25 years of technology and digital leadership experience. This morning, we also announced that Morgan Fox will be joining the organization as our Chief Legal Officer and Corporate Secretary. Morgan brings more than 20 years of legal experience, including 15 years in-house at publicly traded companies including a recent role as GC of The AZEK Company.

Our second pillar is optimizing the portfolio across and within our business units, beginning with addressing underperforming businesses and geographies. On October 15th, we announced that we had signed a purchase agreement to sell our Fiberon decking business for $160 million. This is a great outcome for Fortune Brands and for the Fiberon team. We expect the transaction to

close before year-end, and we intend to utilize the proceeds to reduce net leverage and reinvest in the business. We are also taking additional portfolio actions. We are restructuring our China business and will exit our commercial operations servicing the Chinese domestic market while maintaining manufacturing, R&D, and sourcing functions that support our North American end markets. We expect this restructuring to be completed by the end of the third quarter of 2027.

We will also rationalize the EMEA operating footprint of a business within our water segment, which is expected to be completed by the fourth quarter of 2027. We believe this action gives the business a more competitive cost structure and scalable capacity that can support expansion and profitable growth. We expect these portfolio actions to be earnings and margin accretive. On an annualized basis, these businesses generate a combined operating loss of approximately $50 million to $55 million on revenue of $320 million to $330 million. As we complete these actions, the business may experience some near-term headwinds through 2027, but we expect these initiatives to scale to a full run rate benefit by the end of next year. Beyond these three actions, we will continue to optimize the portfolio for growth and profitability within our segments including driving accretive growth from our connected businesses and addressing pockets in each business that are weighing on profitability and growth.

Our third pillar is building a business-led sustainable growth engine. This year, our focus is on stabilization. 2027 will be a rebuilding year in which we invest towards future growth. We are prioritizing the end markets and channels where we are underpenetrated, accelerating the development and launch of new products, and improving our commercial sales and marketing performance. In general, across our company, we have a strong position in single-family new construction and are under-indexed in the more resilient R&R and commercial markets.

Our fourth pillar is expanding margins while sustaining our growth investments. Through our organizational realignment, we are on track to deliver an annualized run rate of $70 million in SG&A savings by the first quarter of 2027 and expect the recently announced portfolio actions to increasingly contribute as we move through the back half of 2027. As a result, we expect the combined inflection to be fully visible in our results by Q4 2027. At the same time, we will focus on driving operational excellence across sourcing, product engineering, pricing, and mix management. Each of these areas has the potential to deliver meaningful impact over the next two years. We have started executing our back-to-business plan and expect to see some benefits in the last quarter of 2027.

Near term, we expect our results to be pressured by our portfolio actions, our exposure to single-family new construction, a reduction in channel inventory, and a lag effect of shelf space losses from 2025 in the first half of 2026. Water is a longer turnaround that could extend beyond next year. We expect the improvement cycle in our other businesses to be shorter. In outdoors, we expect portfolio and product actions to drive margin improvement. In security, as we lap the shelf resets and continue to improve service, we expect stronger results as we exit 2027.

As we look at the remainder of 2026, we see an incrementally weaker single-family new construction market while repair and remodel demand at retail has been relatively stable but remains soft. As a new management team, we are taking a conservative approach to channel inventory in this period of uncertainty. We also plan to use our net tax benefit to fund additional portfolio and alignment actions in the fourth quarter. These are difficult but necessary decisions that will impact our near-term results but put us in a better position heading into 2027.

Before I close, I want to welcome Pete Clifford, who we've recently appointed as Chief Financial Officer. Pete brings more than 30 years of financial leadership experience including public company CFO and COO roles at AZEK and Cantel Medical. He is a disciplined operator and pragmatic leader who understands the day-to-day realities of running a manufacturing business. I worked with Pete at AZEK, and I'm excited to have him on the team. I'd also like to thank Ashley George for her leadership as Interim Chief Financial Officer through a period of significant change. Ashley has returned to her role as Senior Vice President of Finance supporting our water businesses where she will help drive our efforts to strengthen execution and improve profitability. Ashley, thank you.

We have exceptional brands, we have customers and channel partners who want to win with us, and we have a team that is engaged and moving with urgency. Our job now is to execute. It will take time, and our results over the next several quarters will reflect a company in the middle of that work. We expect the actions we have announced to date will deliver more than $120 million of annual benefit as we exit 2027. Our longer-term target is to exceed 20% underlying EBITDA margins while driving above-market growth. We intend to build a stronger, simpler, and more customer-focused company, one that delivers sustainable growth, margin expansion, and shareholder value. With that, let me turn it over to Pete.

Pete Clifford
Thank you, Jesse. I'm honored to join the Fortune Brands team. As Jesse highlighted, we have well-recognized brands, great products, deep relationships with our channel partners, customers, and pros, and we are building strong teams. As I look at the business, there are opportunities to improve our operational rigor, optimize our cost structure, and bring a more disciplined approach to capital allocation. I'm excited about the opportunity and look forward to reengaging with many of you over the coming weeks and months.

As a reminder, my comments will focus on our results before charges and gains unless otherwise noted, and comparisons will be made against the prior year. Similar to last quarter, our presentation provides a breakdown of the gross and net impact of tariff refunds on reported operating income and EPS for the third quarter and full year 2026. During the third quarter, we recognized 29 million in gross tariff refunds. This amount includes the portion that was recognized as a reduction in inventory in the second quarter as well as incremental tariff refunds recognized in the third quarter related to Phase III of the CAPE process.

Net of variable compensation expense, this translated to 18 million of operating income and $0.14 of EPS in the quarter. For the full year, we expect net tariff refunds to contribute approximately $0.59 of EPS, which is reflected in our updated guidance. In addition, we also recognized a net tax benefit of 33 million or $0.28 per share related to an internal restructuring designed to streamline the legal entity structure of our European operations. The restructuring is intended to reduce future operating costs such as statutory reporting, legal, tax, and treasury costs, and is consistent with our efforts to simplify our organization.

Now turning to our consolidated results for the quarter. Total company sales were 1.1 billion, down 3.1%. The decline in sales was primarily driven by water and security, partially offset by outdoors. Consolidated operating income for the quarter was 156 million, down 24.6% with margins of 14%, down 390 basis points. Third quarter EPS was $1.14. Operating income benefited by 18 million from net tariff refunds while EPS benefited from both net tariff refunds of $0.14 and the net tax gain of $0.28 I just spoke about. Our third quarter effective tax rate was essentially zero compared with 25% in the prior year period, reflecting the legal entity restructuring impact I outlined earlier. Excluding these discrete items, our underlying effective tax rate for the third quarter was approximately 24.4%.

Turning to our segment results. Sales for water were 584 million, down 5.5%. Excluding China, sales were down 4.3%. Sales were impacted by service levels and softer demand in retail. We also experienced further softening in new construction-related demand in wholesale during the month of September. These were partially offset by growth in e-commerce. Water's operating income was 103 million, down 31.8% with margins of 17.6%, down 680 basis points, which included a benefit of 135 basis points from net tariff refunds. The underlying margin decline was driven by unfavorable price/cost, volume deleverage, and higher cost to serve our customers. Within price/cost, we incurred additional expenses related to portfolio optimization and alignment actions. I would also point out that we did not fully realize the price necessary to offset inflation. We believe this weighed on margins several hundred basis points in the quarter. We view this as an execution gap and a key focus of the pricing and mix management work Jesse described.

In outdoors, sales for the quarter were 347 million, up 0.8%. Excluding Fiberon, sales were up 3.4%, driven primarily by favorable year-over-year comps in channel inventory and higher price realization. This was offset by softer new construction-related demand in wholesale mostly in Therma-Tru. Channel inventories were mostly flat in the quarter. However, we lapped the material destocking in 3Q '25. Outdoor’s operating income was 53 million, flat to last year, with operating margins of 15.3%, down 20 basis points. The margin decline reflects lower volumes and higher material and freight costs, which were partially offset by favorable mix. In particular, we have seen significant margin compression in Larson as a result of the sharp run-up in aluminum prices earlier this year, which is flowing through our income statement during the second half of the year. We have not yet fully offset this headwind, and we expect to address it going forward.

Turning to security. Sales for the quarter were 182 million, down 2.4%, reflecting declines in retail and e-commerce, largely due to service challenges. This was partially offset by growth in our commercial channel, which benefited from solid customer demand. Additionally, Yale benefited from continued traction with multifamily customers where we've seen increased penetration over the past year. Security's operating income was 39 million, up 16.9% with operating margins of 21.3%, up 350 basis points. The net tariff refund contributed about 715 basis points to margin, which was offset by higher cost to serve as we continue to recover back to more traditional service levels. In addition, as part of our efforts to refocus our portfolio on our highest return opportunities, we recognized an inventory adjustment related to SKU rationalization during the quarter, which impacted margins by approximately 450 basis points.

Turning to the balance sheet and cash flow. Free cash flow for the quarter was 331 million compared to 177 million last year, primarily reflecting the tariff refund proceeds as well as lower capital expenditures. Year-to-date, free cash flow was 371 million. We ended the quarter with net debt of approximately 2.1 billion and net debt-to-EBITDA of 2.5x. We anticipate our net leverage will decline further by year-end due to the Fiberon divestiture. Cash proceeds from tariff refunds totaled 117 million in the quarter, bringing collections to approximately 126 million year-to-date. We expect to collect the majority of the remaining balance before year-end, which is reflected in our full year free cash flow outlook. The actions that drove our third quarter tax rate are expected to result in a cash tax benefit of approximately 50 million in 4Q '26.

Before we get into our full year guidance, I wanted to provide some context on the operating environment we are seeing entering 4Q externally as well as internally. Externally, we see a more challenging environment in new construction than 90 days ago. Retail R&R is stable but still soft, and we do not anticipate lapping all of our expected share losses until the back half of 2027. Internally, I see a team moving forcefully to embrace the changes required to win. As Jesse mentioned, we are now largely complete with realigning our teams to more customer-focused business units. We have acted quickly against structural cost issues and made important decisions to act on dilutive parts of the portfolio. We are also making incremental progress against improved service levels and making significant progress against our mission of building great teams.

The backdrop for our changes to 4Q and full year '26 guidance can be summarized in a couple of distinct buckets. First, businesses being exited and sold. We have top line and bottom line pressure in China and Fiberon. Second, the market. The market, particularly in home construction, is more challenged and customers are starting to communicate more conservatively. Lastly, channel inventory. New leadership brings a very different philosophy on channel inventory behavior in an uncertain macro. We intend to be deliberate in helping our customers maintain reasonable inventory levels through year-end to derisk the first half of 2027.

A couple of additional points of clarification with regard to the fourth quarter forecast. One, you should think of the water sales forecast as not only a rightsizing of the channel inventory given the macro but also an unwinding of a rather large 1Q '26 load-in that we will comp against in 1Q '27. And second, we anticipate a similar amount of run rate expense in 4Q as 3Q as it relates to investments and accelerating portfolio optimization and alignment. For the fourth quarter, we

expect net sales to be in the range of approximately 925 million to 995 million, and we expect EPS before charges and gains of $0.19 to $0.29.

Relative to our previous guidance, the sales step down comes from three items, the businesses we are exiting or selling approximately, 20 million, the market, primarily single-family new construction, approximately 25 million, and channel inventory, approximately 55 million. On EPS, those three items account for roughly $0.08, $0.11, and $0.12 respectively. Separate from net sales reduction, we also expect to incur roughly $0.14 of portfolio optimization and alignment actions. Finally, as a reminder, we will see approximately a $0.07 headwind to 4Q '26 EPS driven by the tariff refund impact on variable compensation. For the full year, we are expecting sales to be in the range of 4.205 billion to 4.275 billion with EPS of $3.20 to $3.30. In our earnings release, we provided a bridge of the changes on our full year EPS guidance.

As I've outlined here today, our 3Q and 4Q results include a lot of noise for things like Fiberon and China as well as onetime items for net tariff refunds, tax benefits, and other portfolio and alignment actions. Underneath that noise, we believe the core business looks like a business with operating income margins in the mid-teens and EBITDA margins in the high teens. This is in line with what I expected when I took on this opportunity. To be clear, that profile excludes the bulk of the 70 million in SG&A actions taken, the expected benefit of the water EMEA footprint rationalization efforts, and the price/cost recovery missed in 2026 due to our execution challenges on price realization, which I mentioned earlier. As we have articulated, the lag from the China commercial exit and the phasing of the water EMEA footprint rationalization will likely make the first half of '27 more dilutive, and our turnaround will become more apparent in 4Q '27, by which point we will have fully exited China, completed the water EMEA footprint rationalization and put a leaner, more efficient SG&A structure in place, delivering the more than 120 million of annual benefits Jesse outlined.

In addition, price/cost recovery should be more favorable, and we will have lapped some of the more challenging volume quarters. As Jesse mentioned, we are in the early stages of a multiyear improvement plan, and our updated guidance for 2026 continues to reflect our ongoing efforts to stabilize our performance. 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. As Jesse mentioned earlier, our target is to achieve EBITDA margins above 20%. With that, I'll turn the call back to Curt.

Curt Worthington
Thanks, Pete. 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?

Operator
Thank you. We'll now be conducting a question-and-answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your

line is in the question queue. You may press star two 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. One moment, please, while we poll for questions. Thank you. Our first question is from Keith Hughes with Truist Securities.

Keith Hughes
Thank you. We do have a lot going on in the numbers here. I guess from a big picture perspective, can we talk about in the guidance you gave for the year how much is core and noncore? And I've got an eye towards doing estimates for 2027.

Pete Clifford
Hey, Keith. This is Peter. I appreciate the question. Just to reinforce for clarity, we put in the press release and the prepared remarks the elements of the step down for the full year guidance. To be clear, the pieces are the core business is stepping down EPS by $0.23 for the full year, and it's largely driven by the commentary we've given on channel inventory assumption has changed with revenue impacted by about 55 million and then to a lesser degree, about 25 million worth of market largely driven by new construction starts impact on our wholesale channel. As far as noncore, i.e., kind of China and Fiberon, EPS is stepping down about $0.02 driven by a drop in revenue of approximately 20 million. And then we've got several discrete kind of onetime impacts. First discrete item is a tax benefit generated from the legal entity restructuring we were doing in the U.K., which has driven about $0.28 of favorability in the year. The second discrete item is tax refunds have come in favorably in 3Q, adding about an additional $0.07 of favorability to the year. And then lastly, we're proactively using those onetime impacts to make some tough choices faster on the portfolio and alignment decisions that we need to make to position ourselves for a good 2027.

Jesse Singh
Yeah. So, Keith, just kind of high level. Pete dove into the details. The takeaway you should have is the underlying business that will remain in '27, we are lowering that guidance by $0.23 in the quarter. I'm sorry, across the back half of the year, it will manifest itself in the quarter.

Keith Hughes
Okay. I think I see. Thank you. Let me ask one other question on one of the details you gave, Pete, about the 55 million channel inventory hit. Is this more a function of an overload, I guess, it would be in the first quarter of 2026? Or is this more a reaction to the market and adjusting to that in the upcoming, I guess, would be fourth quarter?

Pete Clifford
Yeah, Keith, I think it's probably a balance of both. I think there was clearly a larger load-in in 1Q where our reported growth was about 1%. When you balance that with the reported growth in the fourth quarter, you kind of get a blended growth rate that's more in line with the second and third quarter. And I just think, given the macro of what we heard from customers in September, tone definitively turned more conservative. And with that, I just thought it was prudent that we needed to start thinking about the channel inventory a bit more conservatively in the remainder of the guide.

Jesse Singh
Yeah. And you should think of it as there's a -- we're looking at our channel inventory. And you should think that, as we end '26, we're trying to get closer to where we ended '24 relative to what we see as inventory in the channel. So, it's -- we feel like having less inventory in the channel, especially given our service levels, probably is a natural outcome at this point in the cycle.

Keith Hughes
Okay. I'll pass it on to others. Thank you.

Operator
Our next question is from Ketan Mamtora with BMO Capital Markets.

Ketan Mamtora
Hi. Good afternoon. Thank you. Pete, when I look at the underlying EBIT margin in water excluding the tariff refund, can you just high level break it down for us in terms of how much is sort of unfavorable price cost versus kind of volume deleverage, elevated service costs, just the key buckets here?

Pete Clifford
Yeah. I mean, again, I'm going to give you the answer of six weeks and two days in, Ketan, but I think largely on the margin dilution, about half is probably price cost right now, 25%, I would call out just lost leverage on our fixed manufacturing overhead. And then the remainder is I'll call it the premium service cost as we're having to put more overtime in and air freight to kind of serve customers in a stronger fashion. Those are some of the elements that I think I would kind of call out.

Ketan Mamtora
Understood. Okay. And then when do you expect to get sort of price/cost neutral in water?

Pete Clifford
I think the original view was sometime in this quarter. But candidly, as I've been kind of digging in here in the first six weeks, I think largely, the portfolio has done a really good job of kind of measuring price realization. I think we bumped into a part of the business that hasn't been doing it perfectly, and I think it's helped us understand that we're not fully covering cost here in the third quarter. I think the reality is we probably won't fully cover. It will be closer in the fourth quarter, but I think it will be late 1Q before we really probably have incremental actions in place, maybe possibly the start of the second quarter where we're back to being fully covered from a price/cost perspective.

Jesse Singh
Yeah. Just as Pete highlighted and you know us well enough to know our intent is to be as transparent as possible. I think as we have gone through the year, our price realization is probably coming in under what we may have communicated on the previous couple of calls. And

I think that's really an outcome of a SKU-by-SKU analysis to realize that, in certain cases, we haven't fully executed or realized pricing. And in this kind of a market, it's a blend of a lot of things. It's not just announced price, but it's also the way in which that is executed on the ground and also the way it's offset with any discounting or any kind of individual execution items. And so, I think it's a recognized area where we see a tremendous opportunity to execute better in terms of how we go to market. That's one of the opportunities we have as we look to '27 on the execution side. In addition, it's reasonable to expect given this inflationary environment in a few of our raw material components and with some of our freight that there's probably going to be some additional incremental action as we move through '27.

Ketan Mamtora
[Inaudible] some perspective. Thanks, Jesse. I'll jump back.

Operator
Our next question is from Phil Ng with Jefferies.

Phil Ng
Well, Pete, welcome back. I appreciate all the insights you shared. A lot of numbers to unpack, so I just want to make sure I heard you correctly. It sounds like you're -- obviously, you're making big investments to improve the profitability and you're trying to jam through some restructuring. Did I hear you correctly that the headwinds that you're seeing perhaps in the back half of this year is going to -- that's a good run rate in the first half of 2027, and you really don't see these net good guys and negatives turn positive first half until 3Q '27 and really, the big inflection is fourth quarter '27? I just want to make sure I understand some of those directional components.

Pete Clifford
Yeah. I think first, the commentary in the prepared remarks was more to get myself grounded as well as the investment community on is there anything really different fundamentally about the business. And in my view, there really isn't. If you strip out the noise of China and you strip out the noise of Fiberon and the tax benefits and so -- some of the other discrete one-timers at its core business from an op profit perspective, it feels like it's in the 14% to 15% range with an EBITDA of 17% to 18%. And again, that doesn't include any of the 70 million of structural cost initiatives that the team has been cranking away on. It doesn't include any of the cost -- price/cost recovery opportunity from '26, and it doesn't include the EMEA rationalization. So, the business largely looks like what I expected when I took the opportunity and gets me excited about late next year when we finally have lapped the China exit, we've lapped the EMEA rationalization, and we've got in place that structural cost is fully in the run rate. It gives me confidence that we've set the tone internally that we think this is a 20% plus EBITDA business.

Phil Ng
Okay. Helpful. And Jesse, I guess you've done your tour. You spoke to a lot of your customers. At least it sounds like feedback big picture is constructive. But I guess in terms of these commercial actions and new product innovation and whatnot, is your expectation we're really not going to see much of it until exiting '27? I just want to help us kind of think through some of the puts and takes and appreciate the turnaround in water is going to take longer.

Jesse Singh
Yeah. I -- first, let's -- high level, depending on how you look at the business, we've got two businesses outside of water that are operating, I would say, in a reasonably normal cadence that will benefit from some increased focus on growth. So, if you think about our doors business, we're starting to launch new products. We're starting to accelerate new products. That takes time to get in the market. I would expect that we would see some benefit from that as we exit -- or as we kind of get into the back half, probably into the fourth quarter of '27.

By the way, that business is doing a good job as we speak of offsetting its single-family new construction exposure with just better blocking and tackling on the sales side. And then as you look at our security business, there's a few kind of shelf losses that will lap in the first quarter. So, without being specific, hopefully, we'll start to see some of the benefits of the new product we've launched similarly as we move into the back half of the year. And I think specifically on the water business and on our Moen business, but also Moen and House of Rohl, we have been launching new products over the last six months or so. Those are starting to come into the market, and as those come into the market, depending on the segment, they start having a benefit. And so, you'll start to see some of the benefit of those new products plus better execution. I think you'll start to see some of the benefits of that once again as we move through the back half of 2027.

And once again, I think there's just a lag, right? If you think about the different segments we play in, there's a natural lag of activity. And again, I'll just leave you with one thing. This is not all about shelf space or anything like that, although that's a part of it. A lot of it has to do with just our own execution. Our business in Moen and House of Rohl can do better with our current footprint. We've got great position at retailers, we've got a great position at wholesale, and we've got a great position online. We can execute better with the hand we've been given. And so, that is our intent in addition to expanding the market with launching new products.

Phil Ng
Okay. Really good color. Thank you so much.

Operator
Our next question is from Michael Rehaut with Melius.

Michael Rehaut
Thanks. Good afternoon and great to have the old gang back. Looking forward to working with you both, Jesse and Pete. So, good to hear your voices. First, I just wanted to zoom out a little bit and think about the back-to-business plan. Aside from kind of the portfolio restructuring, when you think about the core changes to the business itself that you're going to endeavor this year and I guess, multiyear, but let's say, particularly over the next 12 months, how should we think about that starting to impact the core profitability and needle moving? Because one thing that I was a little surprised to hear perhaps was that you won't be lapping the share losses until the back half of next year. And I'm just wondering, as you think about executing the plan on kind of the fundamental blocking and tackling of the business, if you wouldn't expect some of that to

yield results maybe over the next two or three quarters? Or is that just being too optimistic relative to the -- how the business works itself?

Jesse Singh
Yeah. I think that there is -- there's a natural lag. So, the results we're experiencing now and the last quarter are really an outcome of what happened a year ago and including profitability, including execution, including some of our supply chain challenges, although some of that happened earlier this year. And I think similarly on the growth side, we believe that the market can and will expand, and we believe we can help that happen. But this is one where there's just a lag on the growth side. I think where you'll start to see the benefit of the blocking and tackling so to speak in the short term is, as we put more of a focus on these core businesses and as we get into some of the profitability of each and every SKU, you can start to see -- as we optimize, deal with some unprofitable SKUs, you could start to see those actions start occurring really over the next two quarters.

The challenge is there's just a lag on that activity actually hitting the P&L. So, it's not that we're not in the middle of starting to execute the actions on the, call it, the profitability and operational excellence side. It's just that there's a lag. You can identify a series of unprofitable SKUs. You can decide what to do with them, but it might take you two or three months, four months, five months to really have that materialize in the market. And depending on where it is, it might even take 9, 10 months. And I think it's similar on pricing and some of these other things we're talking about.

Pete Clifford
I'd just add, Mike, to it. I think as a general statement, just from where we're starting from, I think the security and door side, we have opportunities to move a little bit faster or maybe some of the longer pull is on the water side.

Michael Rehaut
Right. Right. No, I appreciate that, Pete, and thanks for those comments, Jesse. I guess maybe a second question on this idea. When you look at water specifically, I'm just kind of wondering from your examination of the business, what were kind of the core reasons for the share losses? Was it service and/or maybe the sales organization? There was some disruption obviously talked about there with the corporate headquarter moves. Or any other elements that you felt contributed to those share losses? And to your point about doing the work now and there's a lag to showing up, is part of that just to the extent you're able to gain some shelf space back or some share back, you're really not going to see that until '28 because '27 is more baked?

Jesse Singh
Yeah. On your first question, and unfortunately, I'm a football fan, so I'm going to sound a little bit like a coach after a game. I mean, when you have a situation where you take a step back in the market, it's usually not one thing, right? It's a bit of all of the above. We've got a great market. We've got a great position. We matter in the market, and we've got very loyal customers up and down the supply chain. But every once in a while, you don't execute right, and that leads to a negative outcome.

And I'll reiterate, as we look at our future, we don't view this as a zero-sum game. We just see opportunity either where we're already playing or where we have the right to play. That doesn't mean it's necessarily negative to somebody else, where we can execute better and grow and expand our profitability. So, we believe that we'll see some of the benefits of that. Obviously, if I'm talking about a year lag, there's some stuff that we've launched in the market that's doing well, and there's additional stuff that we're going to launch. And there's also some other levers we can pull as we move forward. But this is really just about market expansion and doing what's right for our customers, and we'll win our fair share.

Michael Rehaut
Great. Thanks, guys.

Operator
Our next question is from Susan Maklari with Goldman Sachs.

Susan Maklari
Thank you. Good afternoon, everyone, and welcome back, Pete.

Pete Clifford
Thanks, Susan.

Susan Maklari
I want to go back to the conversation around new products. Can you talk a bit more about how you're thinking of innovation across the entire business? You mentioned some of the efforts in Moen and House of Rohl. Is that where a lot of that is concentrated? And then I guess, what does the new product development mean in terms of your ability to grow the revenues either across the segments or on a consolidated basis? What level of revenue growth are you tying to that 20-ish percent EBITDA margin?

Jesse Singh
Yeah. On the EBITDA margin comment, I think there's a bit of an extrapolation of what we see as an opportunity with the actions we've already announced, additional actions that we have in the hopper and being able to size the business appropriately in a number of different areas. And as you look at that, I wouldn't say our target of -- or our interim target of 20% EBITDA is really predicated on anything more than just our own internal actions and execution based on what we see as the opportunity ahead of us. And so, that's not necessarily predicated on any specific growth rate. And forgive me, Susan, I just forgot your second -- the second part of your question.

Susan Maklari
I was just asking about product development in general. Do you see that as being more focused in a certain area of the business?

Jesse Singh
Yeah. So, I think one of the biggest changes -- so, when you talk about focused business units, we had our product development structured at a corporate level and at a functional level. And what that means is, to give you a little bit of the challenge sometimes in getting things through the system, if you're in our security business and you want to launch a new product, there wasn't a dedicated new product team to your business. You would have to work through a matrix, someone different on the scoping of the product, someone different on the costing, someone different on the execution of it.

So, for us, realigning the new product development team to each business and in many cases the subsegment of the business allows less resources to deliver more efficient and faster new product growth. Your question on the segment is we see opportunity in each of our businesses to really have accretive growth really coming from our new products. And House of Rohl, as you mentioned, is a terrific luxury portfolio. It's been performing better than the rest of our water business. But that business candidly didn't have a general manager for a year, right? And so, our acceleration now with new leadership in place over the last four months really sets us up to kind of push the new product focus there much harder.

Susan Maklari
Okay. That's very helpful. And then maybe a question for Pete. As you think about the cash generation of the business and the leverage and the initiatives that you've outlined, can you talk a bit about what is the optimal leverage for the company and how you think about priorities for capital allocation?

Pete Clifford
Yeah. I think the first goal here is to get below 2.5x leverage, which we expect to do this quarter. I think long term kind of the goalpost probably ought to remain sort of 2 to 2.5x to keep our balance sheet strong enough to give us some flexibility. On week six, day two, I'm not sure I can fully align yet with everybody on the capital allocation priorities. But what I would say is I think we've got to improve our execution where ROIC is clearly the best investing in ourselves first. So, I think we've got to prove that discipline to ourselves that should be the number one priority is investing internally in our growth and margin expansion opportunities. Again, maintaining a strong balance sheet leverage profile, and then any excess, I think, in the near term is clearly going to go towards share repurchases.

Susan Maklari
Okay. Thanks for the commentary. Good luck with the quarter.

Pete Clifford
Great. Thanks, Susan.

Operator
Our next question is from Mike Dahl with RBC Capital Markets.

Mike Dahl
Hi. Thanks for taking my question. Morning, Pete. Welcome back I wanted to talk more about some of the portfolio actions. So, obviously, the Fiberon divestiture we knew about and then the China exit and EMEA restructure are incremental. You kind of highlighted the collective numbers, but those are on three different timelines. So, I was wondering, can you get a little more granular on which contributes what? And then, since it sounds like these will be included in part of your ongoing earnings until the exits are complete, can you give us a better sense of, okay, what does it take to exit the China commercial business in terms of either like investments or severance dynamics or other kind of charges or cash impacts and same thing on the EMEA restructure. And these kind of seem like three of the easiest low-hanging fruits. So, just taking a step back, just give us a sense of post this any other portfolio actions we should be thinking about.

Jesse Singh
Yeah. I'll kind of answer it at a high level and then maybe let Pete take some of the execution. Obviously, on a transaction, once that transaction executes, the benefit will become visible. And so, we're not going to parse it out specifically right now. I would expect on our next call that we'll be able to give clarity and start to report on an ongoing basis in a way that gives you more clarity there. In terms of what's it going to take to kind of execute the EMEA and the China exit, Pete, I don't know if you have any commentary just in terms of -- you've been diving in just on some of the moving parts and why it takes six months.

Pete Clifford
Yeah. I mean, look, we had the announcement earlier this week with our teams, so that part is complete. We will work with our customers that we have over there. I think the bulk of the teams will probably transition through the late first and second quarter, and I would expect the third quarter to be a much more skeletonized kind of crew serving the last of customer requirements. And I think the goal would be to be completely ramped down very early in the fourth quarter.

Jesse Singh
Yeah. And then on the factory reset and operations reset there, it's just really important that we continue to service customers as we kind of scale down and scale up. So, that will really be driven by customer service, and so you should think of any time you're impacting an operation, you want to make sure that you do a good job both not only with the people but also with your customers.

Pete Clifford
And then I think, Mike, obviously, the first quarter, you're going to immediately see the lift on the quality of earnings of Fiberon being out. But as well I think we will look to with our '27 results report water ex China like we've historically at times done here to give people a better understanding and view of what the water business looks like without China.

Jesse Singh
Yeah. One additional point. The EMEA action will benefit the water P&L.

Mike Dahl
Okay. And just second quick question. You talked about using the tax benefit to reinvest in some tougher decisions around optimization and alignment. You were already making some of those investments. Can you just be a little more specific about what is kind of incremental to what you had previously already been doing and had discussed last quarter?

Pete Clifford
Yeah. I think I could give you an example here in the third quarter, Mike. In our connected business, we had inventory base of about $8 million of product that was aged and a little bit older technology, and the decision was where do we prioritize our sales team's time? Do we try and sell an older platform and delay a new product launch, or do we write off the product and get people focused and excited on the new technology and new product launch? And obviously, in this case, we chose to write off that inventory and get the teams focused on what's important and what's the future.

Operator
Our next question is from Sam Reid with Wells Fargo.

Sam Reid
Thanks so much, everyone. You talked a little bit about getting closer to price/cost neutrality as we move into let's call it midish 2027 I believe. Can we talk through the market appetite for pricing? And I'm thinking specifically in water but also in Larson, where there's been some commodity headwinds with aluminum and then also just Therma-Tru?

Jesse Singh
Yeah. Look, obviously, we're not going to get into specifics. Just at a very high level, when we're looking at pricing actions, there's really two sides to it, right? So, one is the actual kind of announcement in the marketplace and that dialogue, call it, list price or however you want to have it, and then the other one is kind of the manifestation or the execution. There's actually three components. Like how effectively do you execute it? And then the third element is the gross to net kind of back-end discounting, what's the right way to promote products, et cetera. I think in general, in all of our markets, we're not sitting here saying -- maybe with the exception of kind of opening price point and maybe a bit in our new construction area, we're not sitting in a situation where we are shopping for pennies or our consumers are shopping for pennies, right? And so, I think it's really important that we just price our products appropriately in the bands that we play in. And we play in a lot of tiers across our product line, entry-level, mid-price point, premium products. It's just really important that we price right within those tiers. And once again, we view opportunity in each of our businesses to be able to take additional actions in each of those three areas that I mentioned related to price.

Sam Reid
Really helpful. And maybe just circling back on to your bridge. The bridge math for Q4 was very helpful. I'd love to drill down a little bit on perhaps some of the portfolio optimization and alignment actions. Can you -- that $0.14 headwind. Could you just maybe decompose exactly

what's embedded in that just in greater detail? Would just love some additional context as we're flowing that through our model and perhaps how to think about that impact continuing into 2027.

Pete Clifford
Yeah. I mean, obviously, it's largely going to be nonrecurring. So, that example I gave you of the $8 million is the biggest piece of the 3Q opportunity set. Candidly, the fourth quarter is a little bit of a placeholder for a guy who is on week six, day number two, but we do suspect that there'll be more there to again accelerate maybe some decisions that were tabled for the last year or two to try and get a jump start on where we want to be in the future.

Jesse Singh
Yeah. And you should once again think of these are onetime in nature because they involve, as Pete pointed out, with some outdated Yale locks to just -- they involve -- it involved the decision to stop selling them and, therefore, take a write-down on what was there. And so, it's those kinds of decisions that we believe are wise to make moving forward to make sure that we've got the cleanest business we can have relative to both growth and profitability moving forward.
All right. With that, thanks again for joining us this evening. I know we have a number of follow-up calls, and we look forward to seeing many of you at upcoming conferences. And with that, have a great evening. Thank you so much.