



Fortune Brands Innovations, Inc.
Fourth Quarter 2024 Earnings Conference Call
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Presenters

Leigh Avsec, EVP, External Affairs and Chief of Staff

Nick Fink, Chief Executive Officer

Dave Barry, Chief Financial Officer and President of Security and Connected Products

Q&A Participants

Susan Maklari - Goldman Sachs Group, Inc.

Matthew Bouley - Barclays Bank

Michael Rehaut - JPMorgan Chase & Co

Adam Baumgarten - Zelman & Associates

John Lovallo - UBS Investment Bank

Operator

Good afternoon, everyone. My name is Joe, and I will be your conference operator today. Welcome to the Fortune Brands Fourth Quarter 2024 Earnings Conference Call. All lines are muted to prevent background noise. Following the speakers' remarks, we will open the call for a Q&A session. At this time, I'd like to turn the call over to Leigh Avsec, Executive Vice President of External Affairs and Chief of Staff. Leigh, please go ahead.

Leigh Avsec

Good afternoon, everyone. And welcome to the Fortune Brands Innovations Fourth Quarter and Full Year 2024 Earnings Call and Webcast. Hopefully, everyone has had the chance to review the earnings release issued earlier. The earnings release and audio replay of the webcast of this call can be found in the Investors section of our website, fbn.com.

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 income, margin, EBITDA, earnings per share, or

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

Joining me on the call today are Nick Fink, our Chief Executive Officer, and Dave Barry, our Chief Financial Officer. Following our prepared remarks, we have allowed time to address some questions. I will now turn the call over to Nick. Nick?

Nick Fink

Thank you, Leigh, and thank you to everyone for joining us today. As we finish 2024 and begin 2025, I'm proud of the progress we've made to continue to re-platform the business and unlock our long-term growth potential. We took several important steps this last year, amidst a challenging backdrop. We further focused our portfolio on the highest growth and most profitable opportunities within our categories. We simplified and aligned our organization uniting our associates behind a new visionary purpose.

We saw market outperformance in key core portions of our portfolio. We integrated in scale, our digital business and announced milestone partnerships in digital water. We had impressive free cash flow and made sustainable margin progress across our portfolio. We did so while also continuing to make strategic investments in brand-building, innovation, and our ongoing digital transformation, all of which have delivered real assets that we plan to activate to accelerate growth. The actions we took over that past year to better leverage this strength of our aligned organization and sharpen our focus on our leading brands, meaningful innovation, and our Advantage (sp) channel relationships give me confidence in our ability to outperform in 2025 and beyond.

Our Fortune Brands Advantage capability are now more effectively deployed across the organization, allowing us to advance our growth and margin journey by reducing cost, optimizing our pricing, and enabling our high-growth focused areas like digital products, luxury, and outdoor living. As we continue our transformation into one aligned organization, we will be able to further leverage our Fortune Brands Advantage capability to create even more value.

Fortune Brands was recently named to the Wall Street Journal's Top 250 Best Managed Companies list of 2024. This recognition is a testament to the progress we've made as a company, especially our growing prominence as a digital brand in our digital products portfolio and reflects the tenacity and innovation of our entire team.

Before we continue, I want to touch on our recent announcement. Starting in the summer of this year, Fortune Brands will begin to move its regional offices into one state-of-the-art campus headquarters in Deerfield, Illinois. We're fortunate to have found a modern and tech-forward environment to call our new home. The result will be a world-class collaborative environment to fuel the company's innovation, accelerate our digital solutions and grow our core products.

Additionally, this campus will further our ability to retain and attract top talent and further build our exceptional culture, centered around our purpose. We expect this action will drive bigger thinking and elevated execution even faster and will unlock opportunities for growth and shareholder value.

We also announced we have simplified our leadership structure. This allows the senior commercial leaders to now report directly to me, and it allows for quicker decision-making and more direct involvement across the businesses. Additionally, Dave Barry will move into a newly created role of President, Security and Connected Products. He will lead our iconic legacy Security business and have direct responsibility for growing Fortune Brands' digital business, including the Yale Smart residential locks, Master Lock connected Lockout Tagout, and the Moen Smart Water Ecosystem, including the Moen Flo leak detection system.

These businesses will greatly benefit from Dave's focus on growth, his acute business insights and company experience, and his passion for our brand and our connected products opportunity. By deploying some of our best talent against our biggest opportunity, I am confident that we will achieve our full exceptional potential.

Now turning to the market and our results. On this call, I will walk through the highlights of our fourth quarter and full year 2024 performance. I will also offer some thoughts on the current macro environment and why we believe Fortune Brands is optimally positioned now more than ever to deliver on our commitment of long-term growth and sustained value creation. I will then turn the call over to Dave for a discussion of our fourth quarter and full year financial results and our performance expectations for 2025, including our view of the market.

For the fourth quarter, we saw net sales of \$1.1 billion, a 5% decrease versus the fourth quarter of 2023. Importantly, our fourth quarter sales were impacted by a third-party software outage in our security distribution centers, the hurricanes in the Southeastern United States and continued softness in China. Adjusted for these impacts, our fourth quarter organic sales were down 1%. Also notable is that when you exclude hurricanes and China, fourth quarter organic sales grew for our Water and Doors businesses, and we estimate our total company point of sale, excluding China, and the one-time disruption outperformed the larger market.

Fourth quarter 2024 EPS were \$0.98, up 3% versus Q4 2023. Operating margins for the quarter were 16.4%, a 60 basis point improvement over the fourth quarter of 2023. For the full year 2024, our teams delivered net sales of \$4.6 billion, flat versus 2023. Full year organic sales were \$4.4 billion, down 5% or down 2% excluding China and the onetime fourth quarter disruption. Our full year operating margins increased 90 basis points versus 2023.

Our impressive margin results reflect the actions we have taken to optimize our businesses, including strategically aligning our operational footprint and focusing our portfolio on the most profitable parts of our business. Importantly, the strong margin performance includes the strategic investments that we have made to facilitate future growth.

Our 2024 free cash flow was approximately \$475 million with a cash conversion of more than 100% of net income. Our cash flow performance is another proof point of our more efficient organization. Our full year earnings per share were \$4.12, up 5% over full year 2023.

Our strong balance sheet and advantaged capital structure enabled us to strategically deploy capital both organically and inorganically. We invested inorganically in strategic platforms, including water filtration and connected lockout tagout, both of which we believe have significant secular growth opportunity.

Finally, we announced that our Board of Directors has approved a new \$1 billion share repurchase authorization, demonstrating the confidence we have in our cash generation as well as our focus on creating long-term shareholder value. Now I would like to highlight in more detail the actions we took in 2024 that will position our company for future growth.

Starting first with our digital business. As a reminder, our digital business includes all of our digital products in both our Water and Security segments. In 2024, digital sales were \$214 million, with significant growth in the Flo business. At the end of 2024, our full digital business has 4.7 million users, inclusive of over 200,000 new device activations in the fourth quarter and with a strong point-of-sale trajectory as we head into 2025. In our digital water business, Flo's success, both in terms of sales and partnerships, far exceeded our expectations.

At the end of 2024, we had 12 partnerships with insurance companies and other key sales partners including our precedent-setting partnership with Farmers Insurance. This is particularly impressive as we started 2024 with a new team and no partnership. In 2025, we have already signed with another one of the largest insurance companies in the United States with significant access to high-net-worth homeowners. As we discussed on the last call, the number of homeowner policies collectively represented by these insurance partners is in the tens of millions, and we are laser-focused on converting these opportunities into sales.

For our fourth quarter, retail and e-commerce POS for Flo was up over 100% versus the fourth quarter of 2023 and sales for the full year grew well over 100%. We invested meaningfully in Flo, including an innovative marketing designed to drive awareness as well as key functionality and design updates to make the user and partner experience more seamless. We're converting sales opportunities faster having recently added additional dedicated resources.

In the quarter, we reduced the partner onboarding time by two-thirds, and we are now able to implement marketing and sales activation in less than 30 days after signing. Looking to 2025, we will continue our focus on not only entering into new partnerships but accelerating our sales conversion with the partners that we already have.

We expect our Flo sales to continue to increase rapidly and have already seen acceleration as we begin 2025. Based on the strong sales trajectory, we see a path towards \$100 million in annualized sales in 2025. We're looking to launch new subscription-based pricing models in the first half. We've increased our awareness campaign in response to inclement weather across the nation as well as the tragic fires in California, which have elevated public awareness around the need to address the interconnected insurance and affordability crises.

Our digital Security business also took some transformative actions for the past year. First, we continue to build partnerships with our Yale business. We signed 14 new partnerships in 2024 with companies like Airbnb, ecobee, and ADT. As we lap significant destocking and product life cycle headwinds, we expect these new partnerships will reaccelerate our growth.

We acquired a stake in a connected lockout tagout software platform, which we expect will greatly accelerate our leadership in this emerging space. As companies look to keep their employees safe, reduce

insurance costs, and make their operations more efficient, our connected lockout tagout hardware and software platform will be the best-in-class solution.

As we look to 2025, we are very excited about the future of our connected business and its ability to generate recurring revenue. Under Dave's focused leadership and commitment to growth, we believe our connected opportunity is better than ever. We continue to expect connected sales to be at least \$1 billion by 2030. This growth will be driven by rapid expansion of our digital portfolio, including growth in Flo, our emerging Master Lock cLOTO Solution, and a return to growth by Yale as our new partnerships ramp up and our inventory stabilize. We expect digital will contribute 150 basis points of growth to our full year 2025 net sales, and we are working on accelerating this performance.

We took steps to streamline the portfolio, optimize our operations, and work more quickly and efficiently. Throughout 2024, we strategically focused on the highest growth and most profitable parts of our core portfolio and walked away from some of the less attractive and nonstrategic parts of the market, which we estimate at a 150 to 200 basis point impact on our 2024 sales. This has allowed us to focus our best resources on our biggest and most attractive opportunities, especially when the markets return to growth.

We also took key operational steps, including aligning our footprint, opening two new sites for our water business and optimizing our supply chain ahead of 2025. These capacity investments leave us with room for expected growth in the coming years. Importantly, in 2024, we also took steps to prepare for potential supply chain disruptions related to tariffs or other geopolitical situations. We have significantly increased our flexibility and reduced our tariff exposure from China with the line of sight to create cost to reduce this exposure to less than 10% of total cost by the end of 2025.

We have similar stance in Mexico and are executing on strategies to reduce this exposure as necessary. We have leveraged our digital capability to prepare ourselves to react quickly in any environment, and we believe our aligned supply chain teams, robust data, and strong supplier relationships leave us well positioned relative to our competitors.

Now turning to some thoughts on the market for our products in 2025. As we enter 2025, we are prepared for a dynamic environment. We're confident in our ability to return to top line outperformance based on the actions we took in 2024, the strength of our brand, our meaningful innovation, and new product introductions and our connected product growth potential.

The need and desire for homes remains incredibly strong, and our products are well positioned in the context of the larger macro environment. Within the larger market, the issue of housing affordability and substandard imposter brands are both of paramount importance and receiving a lot of attention. We believe this current focus will provide us with opportunity for both our core product as well as our digital product. We will be very focused on articulating the value and benefits consumers get for our product and why purchasing strong brands that stand behind the safety and effectiveness of their product matters more than ever.

While it is difficult to call when exactly a recovery will occur, we believe this fundamental demand, together with our strong and optimally positioned brand, will result in medium- to long-term tailwinds for our business in both new construction and repair and remodel. The R&R market has generally stabilized relative to the post-COVID normalization period, although it's still negative, and existing home sales have

likely found a bottom after three years of decline. That said, recent rate trends and uncertainty regarding policy, inflation, and geopolitics are likely to inhibit market growth in the near term.

Starting with new construction. We expect the single-family new construction market to be flat in 2025 with both starts and completes up low single digits, partially offset by the lag impact from the 2024 second half slowdown. As a reminder, new construction represents around a quarter of our total sales. Our businesses, particularly our Moen and Therma-Tru brands, enjoy very strong relationships with many large national production builders and the channel partners that serve them. Despite higher-for-longer rates, large builders are offering incentives to support volume in the near term, which will continue to be a tailwind for us.

Turning to R&R. The R&R market remains dynamic, and there are many variables that are impacting the repair and remodel space, including consumer savings and confidence, employment levels, home equity levels, and existing home turnover. We currently expect the R&R market for our products to be flat to up in 2025 with growth weighted towards the back half. R&R is impacted by a variety of factors. While we expect rates will be higher for longer, we also expect higher existing home sales and increased rates of home equity extraction.

Even when accounting for the COVID boom, the levels of R&R volumes since 2019 are under trend. However, as consumer confidence improves and consumers increasingly look toward their homes as a source of capital equity, we believe people will increasingly leverage their home equity for renovation projects through a variety of vehicles including refinancing, HELOC loans, HELOANS, and home equity agreements.

Now let me turn to segment results. Starting with water innovations, our fourth quarter sales were down 3%. Excluding China and the impact of the hurricane in the Southeast United States, organic sales increased 2% with above-market point-of-sale growth in our House of Rohl and Emtek businesses.

Our margins increased 190 basis points over fourth quarter of 2023, while we continued to invest in our priorities like digital and marketing. Our margin results reflect our focus on the most profitable parts of the market as well as the work we've done to align and streamline the organization and improve the efficiencies of our businesses.

For the full year, water innovation sales were flat, and organic sales, excluding the impact of China and hurricanes, were down 2%. For the full year, we saw 80 basis points of margin growth.

Looking forward to 2025, we continue to expect a dynamic environment, especially in the first part of the year with clear opportunity for us to differentiate ourselves. We will focus on delivering above-market sales performance across the segment by focusing on the highest growth areas within our core businesses and continue to accelerate our leadership in digital water.

We plan to help consumers and customers better understand what our products stand for: design, dependability, and innovation. We once again won America's Most Trusted Faucet Brand and plan to leverage that strong consumer and pro sentiment in the face of the number of imposter and counterfeit brands in the marketplace. We will continue to invest in our key priorities, including branding and marketing and our digital products. These targeted investments will help drive our strategy to grow the core and accelerate digital and connected products.

2024 represented a tipping point for our Moen Flo Smart Water leak detection business, and we expect this to only accelerate in 2025. Our sales pipeline is substantial. And even with conservative conversion estimates, we have the opportunity to realize significant sales. We will continue to invest in this growth opportunity both to support product functionality as well as marketing and other activation efforts. We believe the current focus on insurance and affordability, together with our leading position in this space, will result in outsized growth.

Our House of Rohl portfolio, which now includes Emtek, grew in the fourth quarter as our brand, product and showroom strategy resonated with luxury consumers and design. We opened a new manufacturing and distribution facility in the U.K. to better serve our customers, which will continue to come online in 2025. We're also still rolling out our synergy wins for Rohl and Emtek, particularly in showrooms. We are excited about the future of our luxury portfolio as our powerhouse brands continue to delight consumers and designers alike.

Finally, China was again a headwind in this quarter. We have re-platformed the cost structure of the business given the challenging market. As a result, any future decline should not have a significant impact on our P&L. We believe the market has largely stabilized at the bottom, although we will have one more quarter of challenging comparable.

Now turning to Outdoors. Our fourth quarter sales were down 2% with low single-digit point-of-sale growth in the segment, driven by our Doors business. Our margins were 18.2%, an increase of 430 basis points over the fourth quarter of 2023. For the full year, Outdoor sales were up 1%, and we saw impressive 310 basis points of margin growth. In 2024, we benefited from our strong relationships with the big builders, accelerated the evolution of the brands in our Outdoor segment, and introduced exciting new product innovations.

Looking forward to 2025, our focus is on continuing to grow our Outdoors brand by leveraging our strong brand position and channel relationships, coupled with innovation. We're particularly excited about the potential for our LARSON brand. We recently unveiled our new LARSON perfect aisle product reset at our retail partner, and the initial results from our refreshed and innovative approach to this category are very encouraging. We expect to have over 1,700 stores with refreshed product display by the middle of 2025.

Turning to Security. As I already mentioned, our Security segment was impacted by a third-party software audit at our distribution centers, which exacerbated a soft sales environment and customer destocking. Our teams are laser-focused on delivering on our commitments to our customers, and I thank them for their tireless work to recover from these challenges. Our fourth quarter sales and margin performance reflect these issues. Our fourth quarter sales were down 17%. Excluding the impact of the software outage, our fourth quarter sales were down approximately 10%.

Our margins were 9.3% because of the impact of the outage as well as the expected timing of investments related to our Yale business. For the full year 2024, our sales were \$694 million, down 4% and organic sales, excluding the software outage, were down approximately 10%. For the full year, margins were 16.1%, a 10 basis point increase versus last year.

The performance of this segment in 2024 did not meet our standards, and we have identified critical areas for us to focus on as we work to address these challenges directly and head-on. We've already taken actions under Dave's leadership, and I'm confident that we will improve this business.

We've made progress on some exciting brand and product work, which will be unveiled in 2025, including the first major branding campaign from Master Lock in several decades. We're already seeing proof of our brand strategy in action. For example, recent safe advertising, highlighting the performance and trustworthiness of our brand's accelerated point of sale, which further improved after the recent tragic LA fire.

As consumers face this terrible crisis and as it was highlighted around the globe, the work that we have done around helping people understand what our brands stand for, namely safety, dependability, and quality, became even more important and gives us confidence in our larger strategy of focusing on meaningful brands and innovation. We saw significant point-of-sale growth in those markets where consumers were focused on these risks.

Looking forward to 2025, we have a new proven leader, a renewed focus on differentiating our iconic brands and products and a robust partnership pipeline for Yale. We are rolling out a connected lockout tagout solution and see it as a breakout opportunity for our Security business.

To recap, 2024 was a year of transformation and execution for Fortune emits a dynamic external environment. Our teams build new assets across brand, innovation, and digital which will accelerate growth as we deploy them in the marketplace. Our margin results and market outperformance in key parts of our portfolio give us confidence in the future. We took decisive steps this year to better position ourselves and I'm proud of what our teams achieved in 2024.

In 2025, which Dave will speak to in greater detail, we will focus on driving above-market growth and accelerating our areas of advantage. We will look to sustainably grow margins and continue investing behind our most strategic opportunities. We will execute our larger strategy of focusing on our supercharged categories.

We expect 2025 to be another breakout year for our connected products, particularly our Flo devices. We will take concrete actions in our business to ensure that we are best positioned for long-term growth. Additionally, we will manage any period of continued volatility by responding quickly and remaining focused, all while actively positioning Fortune Brands' innovations for the future. I will now turn the call over to Dave.

David Barry

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

Before I begin, I would like to take a moment to address my new role. I have found my experiences as CFO to be incredibly rewarding, and I am grateful to all those with whom I've built relationship, including many of you on the call today. I look forward to the next phase of my career and journey with Fortune Brands in

my role as President of our Security and Connected Products businesses. I'm fully confident in the long-term growth opportunities of both of these businesses and I'm excited to help advance our value creation.

In the meantime, I will be assisting with the search for our next CFO and will partner closely with my successor, ensuring a very smooth transition. As Nick highlighted, our team is focused on a tight set of priorities amidst a dynamic external market while continuing to best position the company for the future. For the fourth quarter, sales were \$1.1 billion, down 5% and organic sales were down 1% when adjusting for the impact of China and excluding the onetime event.

Consolidated operating income was \$181.6 million and total company operating margin was 16.4%. EPS were \$0.98. Fourth quarter free cash flow was approximately \$212 million. For the full year, sales were \$4.6 billion or flat versus last year and organic sales were down 2%, excluding the impact of China and the onetime disruptions in the fourth quarter. Consolidated operating income was \$780.6 million. Total company operating margin was 16.9%, a 90 basis point improvement. Our EPS were \$4.12. Our total free cash flow generation was an impressive \$475 million.

Now let me provide more color on our segment results. Beginning with Water innovations, sales for the fourth quarter were \$645 million, down 3%. Organic sales were up 2%, excluding the impact of China and the hurricane. For the year, sales were flat with organic sales, excluding China and the impact of the hurricanes down 2%. Water Innovations operating income was \$152.6 million in the fourth quarter. Operating income for the full year was \$603.8 million. Operating margin was 23.7% for the quarter and 23.5% for the full year.

Consistent with our returns-focused investment strategy, our Moen brand investments are generating results as we focus on accelerating the consumer and channel awareness of our new-to-world flow technology and invested in our core brands. As we discussed, we selectively focused on the portions of our portfolio with the highest potential for returns. In our luxury portfolio, we made key investments in capacity for our House of Rohl products. Now as one combined entity with Emtek, we are excited about the future of our luxury brand.

In China, sales declined 30% in the fourth quarter and 31% for the full year. While the market seems to have stabilized, we do expect another challenging comparable in the first quarter of 2025, due to lapping accelerated completion in Q1 2024. Looking to 2025 and beyond, this business will continue to provide innovation and growth optionality. As a result of its re-platform size, it is no longer a material portion of our business and future declines, if any, should be less impactful to our P&L.

Turning to Outdoors. Fourth quarter net sales were \$303 million, down 2%. For the full year, sales were \$1.4 billion or up 1%. For Doors, sales were flat in the quarter and up low single digits for the year. Decking sales were down mid-teens in the quarter and were down low teens for the full year as a result of softer demand environment and destocking. Outdoor segment operating income was \$55.2 million during the quarter, up 29%.

Operating income for the full year was \$218 million, an increase of 25%. Segment operating margin for Outdoors was 18.2% in the quarter, an increase of 430 basis points and 16.1% for the full year, a 310 basis point increase. Outdoor has delivered a strong sales and operating margin year. These impressive margin

results are a direct impact of the work we are doing to drive innovation and expand distribution for our leading brands.

Finally, turning to Security. As Nick discussed, we are impacted in the fourth quarter by a third-party software outage, which impacted our distribution center. Fourth quarter sales were \$157 million, down 17% or down 10% when adjusting for the outage. Our fourth quarter operating margins were 9.3%. Full year sales decreased 4% to \$694 million and organic sales decreased around 10% when adjusting for the impact of the software outage. Our full year operating margins were 16.1%. Looking forward, we will be investing in the core business with new marketing and product innovation. Additionally, we will focus on advancing our connected portfolio, including our residential smart lock and our connected lockout tagout platform to return this segment to growth.

Turning to the balance sheet. Our balance sheet remains strong with cash of \$381 million, net debt of \$2.3 billion, and our net debt-to-EBITDA leverage is 2.4x. We finished the year with the full \$1.25 billion available on our revolver. Our strong 2024 free cash flow of \$475 million is a proof point of how the entire Fortune Brands organization is effectively working together. We also opportunistically repurchased \$50 million of shares in the quarter and \$240 million of shares in the year. In the first quarter of 2025, we repurchased an additional \$75 million of share.

Today, we announced that our Board of Directors has approved a new \$1 billion share repurchase authorization to replace our existing authorization. This new repurchase authorization demonstrates the confidence we have in our business as well as our ability to drive cash flow and working capital initiatives while being mindful of our leverage target.

To reflect on 2024, the external environment remained challenging and impacted demand for our product. However, our team is focused on executing key strategies and leveraging our strength in brands, innovation, and channel to drive strong margin and cash flow. We work to transform into an aligned and increasingly agile organization that is prepared to respond to any macro condition.

As Nick outlined in his remarks, we believe that Fortune Brands is uniquely positioned, now more than ever, to deliver on our commitment of long-term growth and sustained value creation. I remain fully confident in our ability to deliver results by focusing on those categories where there are unique growth opportunities and where we have the right to win.

As we enter 2025, we are taking a cautious view on our core markets given recent interest rate volatility and geopolitical uncertainty. However, medium- to long-term trends remain favorable and the consumer remains engaged with our category. For example, Google search results on home renovations are up 7% versus last year. We remain committed to delivering above-market growth, expanding our margins, and accelerating cash generation while continuing to deploy our capital in effective and impactful ways.

As we have demonstrated over the past few years, our company has the ability to generate significant amounts of cash even in down environments. Additionally, our recent capacity investments leave us well positioned to drive volume leverage through the P&L as volume return.

For 2025, we expect the global market for our products to be down 2% to up 1% with the U.S. housing market also down 2% to up 1%. Within this market forecast, we expect U.S. R&R to be down 1% to up 2%

and U.S. single-family new construction to be down 2% to up 2%. We expect the market in the first half of the year to be below the midpoint of our full year range as R&R remains at the lower end of our estimate and the lag impact from the second half 2024 slowdown in as single-family new construction materializes in the business.

As the year evolves, we will continue to monitor market trends as well as our performance, and we'll update our guidance as warranted. Based on those assumptions, we expect full year net sales to be flat to up 3%. We expect operating margins between 16.5% and 17.5%. This includes our expectation that digital products will contribute 150 basis points of growth on full year consolidated company sales, and we are working on accelerating this performance. Based on these assumptions, we expect full year EPS within the range of \$4.15 to \$4.45, the midpoint of which represents a 4% increase versus our 2024 results.

Now let me speak to our outlook for each segment as it relates to our overall guidance. We expect Water net sales flat to up 4%. We expect segment operating margins between 23.5% and 24.5%. We expect Outdoor net sales to be flat to up 3% with segment operating margins between 16% and 17%. We expect Security net sales to be flat to up 3% and operating margins between 16% and 17%.

We remain hyper-focused on generating and deploying cash and are pursuing incremental working capital reduction initiatives in 2025. We expect 2025 free cash flow conversion of around 115% to 125% of net income, which implies free cash flow of around \$580 million to \$620 million, including capital expenditures of around \$100 million to \$140 million.

Consistent with our track record, following organic investment and paying an attractive dividend, M&A and opportunistic share repurchases remain our top allocation priority. We plan to actively monitor for dislocations in our share price and take advantage of these opportunities to repurchase shares, enhancing shareholder value. As discussed, we are going into 2025 as a more focused organization, well positioned for acceleration when the market returns to growth with a solid core and exceptional opportunities for growth in digital.

We remain confident in both the long-term fundamentals of our markets and our ability to outperform by focusing on those parts of the market with the best opportunities for long-term growth, maintaining our margin journey, and generating cash. I will now pass the call back to Leigh. Thank you.

Leigh Avsec

Thanks, Dave. That concludes our prepared remarks. We will now begin to take 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 re-enter the queue to ask additional questions. I will now turn the call back over to the operator to begin the question-and-answer session. Operator, can you open the line for questions? Thank you.

Operator

Thank you. Ladies and gentlemen, if you would like to ask a question, please press "*" "1" on your telephone keypad and a confirmation tone will indicate your line is in the question queue. You may press "*" "2" if you would like to remove your question from the queue. For participants using speaker

equipment, it may be necessary to pick up your handset before pressing the "*" keys. And our first question comes from the line of Susan Maklari with Goldman Sachs. Please proceed.

Susan Maklari

Hey. Good afternoon, everyone.

Nicholas Fink

Hi, Sue.

Susan Maklari

Hi, Nick. You did a nice job of outlining a lot of the initiatives and the actions that you've taken over the last 12 months in your remarks. I guess given the environment that we're coming into in 2025, can you talk a bit about how we should be thinking about those efforts as we do look to this year, put some context perhaps around what some of them can mean for the business over the coming quarters?

Nicholas Fink

Sure. I'd be happy to. And I'll give you some context and then maybe Dave can then shed some light on it as we kind of think of how it moves through the year. So if I take a step back, just look at '24, I mean, obviously, it was still a challenging, although stabilizing towards the end of the year, macro environment. And within that, certainly some choppiness.

But if I step back and kind of look at what were the big profit drivers of the business and where do we look to see those? If I look at Water, we take China out of the mix, which does create a lot of noise and the hurricanes we had at the end of the year, we got Water growing 2% in the quarter, so nice growth there.

I look at some of our furniture, which is the profit engine of the Outdoors business, grew well above 2% in the fourth quarter. And so you had some really big parts of the core that are growing really nicely, and we're driving more momentum, I'll touch on that, into those.

Then look at kind of future core, right? We talked about the Flo point of sale, that's retail and e-commerce point of sale being up over 100% in the quarter. Flo itself, inclusive of insurance grew over 200% in the quarter and 100% for the year. And that momentum we see continuing into 2025. And so we've got both some big profit drivers with momentum as well as future core momentum.

Certainly, as I said in the remarks, Security is a hotspot. Point of sale was down mid-single digits, so better than the reported result by far. But there is work to do there to get that portfolio going. We've got some innovation coming and some brand work for the first time in a very, very long time, coming for that business that we believe is going to drive some real differentiation.

So when I take a step back, I look at that. We've done a lot of work in the year to build digital assets in the connected business. Those are coming online. You've seen the performance in Flo, in particular. We built marketing assets, which are a product that are bringing the company together in a more aligned way and leveraging our marketing team across entire business. I think you're going to see those really for the first time ever, come to life in '25. And we have a very solid marketing plan as solid investment behind it.

And there are innovation efforts. I mean, you'll see new products in places like Master Lock. You're going to see, as I referenced already, very innovative displays rolling out in a place like LARSON. So a lot of really solid assets developed in '24 to drive growth in '25.

And then a final point, and I'll let David add some color if he wants, is we do lap a lot of noise in '24 that won't be there. So we see China is actually normalized and stabilized in terms of quarterly sales. There's noise in the laps, that goes away after the first quarter. And then we walked away from a lot of commoditized business in '24, things like steel doors or window lineals, bar safety. And as we work through those laps, that was 150 to 200 basis points of headwind just in those, you don't have those repeat in '25. That gives us a lot of confidence in our outperformance of the market just based on the momentum of the things I described.

David Barry

Yeah. And Sue, I'm happy to give a bit of context around our guide and what's implied. Sequentially throughout the year, I think one point, as we step back and look at it, we are erring on the side of conservatism from a market standpoint, given the current environment, but accelerating areas where we have growth momentum to drive really 200 basis points of market outperformance regardless of the macro backdrop. So I'll start with that.

If I step back and look at our first half, second half sales cadence, there's 49% of sales in the first half. We expect 51% in the second half. So a very normal seasonal build for us across the year. I think importantly, the guide does not include a significant ramp in the market in the back half. So we're going to see a normal seasonal level of sales. When you translate those sales to prior year comps and you have the first half down around 1% and the second half up around 4%. But again, very seasonal cadence across the year from a sales perspective.

Now, Nick touched on some of the reasons to believe, but fully lapped low-margin business. We've exited China being challenging in the first quarter. We expect it to be roughly flat for the balance of the year. We have digital accelerating through the year and then the nonrepeating impact from our fourth quarter headwinds. So I feel confident in the sales guide we have that there isn't this big back-half ramp driven by the market or other characteristics.

Looking specifically at the first quarter, Sue, I'd say sales, it will be our lowest quarter for the year. And again, inclusive of China, we see sales down around 4%. And China is going to be a 2 percentage point headwind. That's low single-digit POS in the first quarter, and that's roughly what we've seen year-to-date. So our trends support that.

And then looking at margin cadence, I'd say there are three things that we have really good visibility to given our inventory positions and lead times. So one, we see the timing of some operational costs and absorption coming off the P&L and hitting the first quarter specifically. Those are going to reverse out as we move through the year. We have some incremental investment timing, and then we have those favorable prior year comps in the fourth quarter that won't repeat.

So as I look at our margin cadence, I see first half down--or first half operating margin of 14.5% to 15%, with the first quarter around 12% to 13%, including about 225 basis points of margin compression from those ops costs that ultimately reverse out. That leaves a second half margin of around 20%.

And again, reasons to believe as we look at it, the cadence of those operational costs moving through and the absorption moving through, the continued ramp of digital driving mix and non-repeated one-times in the fourth quarter that are going to boost that margin as we get there in the back half. So I think we're taking a prudent approach to the year and really looking to accelerate the growth momentum that we have and have really good line of sight to what's coming on off our balance sheet in and out of the cost bar as we move through.

Susan Maklari

Okay. Very helpful color. And maybe just following up, it sounds from your remarks that the high end of the market is still holding on fairly well, given what you've seen in Rohl and some of the other parts of the business. Just any commentary on how you're thinking about the state of the consumer coming into the year? And what you are seeing across the different price points and how maybe that could play out over the coming quarters?

Nicholas Fink

Yeah. I'd say, look, the consumer generally, I think, is still being very cautious the way, even in the start of the year, we're seeing a consumer behave pretty similar to Q4. I would say even the point of sale, which we get daily read if we want, is almost tracking maybe just slightly under, which was consistent with how they tracked last year from a dollar basis. So I think in general, the consumer is still very cautious, the general consumer.

But you're absolutely right, at the higher end, we're seeing a lot of resilience. And to see that performance out of House of Rohl is great, and the House of Rohl has got a lot of stuff coming online this year. So you're seeing a lot of resilience, and we'll continue to lean into that.

And then for the rest of the portfolio, we've done a lot of work in '24 that will roll out in '25 to really better hit on the differentiation around our brands. And you heard a lot in the prepared remarks around the trustworthiness, the safety. And we've seen a lot--I've talked about it before, what we call counterfeit or imposter products in the marketplace that are very sharply priced. And I'm not talking about private label. That's been around, we compete with that. That's no problem. I'm talking about things that claim, falsely claim to have product attributes or safety standards that they don't.

We're going to--we've already started to talk about some of that in our safe business. We've seen very strong response on point-of-sale level. We're not going to get talking about it more in Water and in other parts of Security. And I think as you do, you then really sort of give in to those reasons to believe why should a consumer pay for these products. And absent that, there's a lot of consumer caution. I think with that, we see strong consumer response.

Susan Maklari

Okay. That's helpful. Thank you both for all the color, and good luck with everything.

Nicholas Fink

Thanks, Sue.

Operator

The next question comes from the line of Matthew Bouley with Barclays. Please proceed.

Matthew Bouley

Good evening, everyone. Thank you for taking the questions. Can I ask on connected products, I think you spoke about 150 basis points additive to growth in 2025. I guess just a few questions, if you can kind of level-set us. I think I heard you say \$214 million is the starting point, and correct me if I'm wrong, from 2024.

So can you speak to the building blocks of the 150 basis points? Is that coming already in Q1? Or does it kind of ramp through the year? And kind of what do you have clear line of sight to already versus kind of additional milestones we should be looking forward to? So thank you.

David Barry

Hey, Matt. It's Dave. Happy to touch on that. And as Nick mentioned in his remarks, we made significant progress in this space. And as I move into my role to work closer with this team and really focused on executing sales activation and conversion while also expanding the aperture on our strategy and where we can play and where we have the right to win. So I'm excited to do that as I get into this role.

So if we look at what's embedded in the guide, you're correct, full year impact on growth for--on the total Fortune growth is 150 basis points. In the first half, probably 100-ish basis points of growth. Second half, maybe closer to 200, maybe a bit more than that of growth. And remember, in the second half, we're comping the Yale inventory reduction. So this is net sales growth that we're talking about and not POS.

I mean, we continue to see POS ramp strongly. It's up in the--up 77%, 70% to 80% in the first quarter of this year already. So that trend has continued for Water. And we see POS growth on the Security side as well in our core channels. It's really just on the partnership side, bringing new products in, transitioning old products out and getting that back to growth that we expect to occur by about second quarter to third quarter.

So we're excited. I mean, the momentum is continuing to build. The team continues to fill the top of the funnel from a partnership standpoint, and we're really focused on pulling those sales through the funnel and executing.

Matthew Bouley

Okay. Got it. Thank you for that. And then secondly, I wanted to touch on the tariffs, which you had mentioned at the top. I think you said maybe low double-digit or 10% and --or line of sight to getting below 10% in China. And I think you said Mexico was similar. Can you just elaborate a little bit on, I guess, what you could do specifically with Mexico since this is obviously newer this time relative to a few years ago and then Canada as well? And specifically, any other kind of international sourcing that we should consider given the kind of uncertainty for how this is all going to play out? So just kind of any framework around the tariffs there. Thank you.

Nicholas Fink

Yeah. Matt, I'll start with--just give you some conceptually and philosophically how we've approached it, and Dave can give you some of the specifics. But--and we've talked about this really over the last few

years. But remember, like going back, we've sort of been at this tariff thing since plywood tariffs first hit, I think around 2017, we had to move \$100 million worth of spend and we did that very quickly. And the team has really built a very, very strong bench in managing tariffs.

Our philosophy over the last couple of years has really been around supply chain agility versus kind of pick a specific geography to bet on. And so doing things I don't want to get into competitively sensitive detail, but doing things around the portfolio that allows us to move product very, very quickly and then building out redundant supplier networks that allow us to move things very, very quickly around the place.

And so while it's certainly been interesting to watch exactly where a tariff may land or may not land. We've done a lot of work to be able to move very quickly as that happens. And so that's been the approach. And I'll tell you, I'm glad we have it versus making a singular bet, say, on one geography.

The other thing I'll just add, and I've spent a lot of time with Leigh, who also manages external affairs, in D.C. talking to the administration. And it's clear that there certainly is the idea of trading balance tariffs, but there is an idea around universal tariffs. And to the extent that that comes to fruition, we have a very strong North American and U.S. manufacturing base.

We're vertically integrated in some parts of the business and still have maintained very strong manufacturing footprint in all other parts of the business. And so we view that as potentially actually being quite a competitive advantage given that we can combine this flexibility with our existing footprint with a great workforce here, and we think we can very, very quickly move to service our consumers and customers in a competitively advantaged way.

David Barry

Yeah. And Matt, I would add just to clear what's in the guidance, we have the impact from the 10% incremental China included in the guide and we also believe our EPS range captures any potential impact from Mexico and Canada. Given what Nick said, the team is working on--for Mexico specifically and for Canada, actually, structuring options, different ways to think about our U.S. content in those products to reduce our exposure and ultimately reduce the price that we would take in the market. But ultimately, while we work all of our internal levers and actions, at the end of the day, what's left will pass through and then invest behind what we pass through to tell the story of our brands and why they are superior.

Matthew Bouley

Great. Thanks, guys. Good luck.

Nicholas Fink

Thank you.

Operator

The next question comes from the line of Michael Rehaut with JPMorgan. Please proceed.

Michael Rehaut

Thanks for taking my questions. Good afternoon, everyone. First question, I wanted just to circle back to the organic growth ambitions or guidance. You kind of highlighted obviously digital contributing 150 out of the 200 bps of growth above the market.

I think in prior years, you've kind of, when giving guidance, often laid out maybe 100 to 150 basis points of growth above your end market. So I think some people were maybe thinking of the digital opportunity of something above and beyond your normal above-market growth opportunity. So when you think about the 50 basis points outside of the digital that's contributing to the top line, maybe being a little less than before. Any thoughts around, let's say, the core portfolio and the opportunity to contribute to above-market growth versus digital?

I know, certainly, you're kind of thinking of them together, but at the same time, I think most people view digital as kind of an incremental opportunity to the core business. So just any thoughts around growth contributions from the nondigital side of the business, how that--how you think about that over the next couple of years?

Nicholas Fink

Look, I think that's a very fair challenge. If you look at '24, as we said earlier, we did walk away from some low-margin business, and we did it very purposely as we concentrated the efforts of the business on the digital side, right? In order to achieve what we've achieved in digital, when we've had to make choices around do we pursue things that were like OEM products or window lineals, et cetera, we've chosen to focus there where we know the future growth is going to be.

And so as we built this year's plan, we certainly want to see the core outperform. And we do, as I said earlier, have some real assets that we're deploying into the market. There is some innovation that's coming that you'll see hit that is very exciting. There is branding assets and there are more dollars going against driving those trading assets into the market and telling that story, and so we expect that to deliver.

But I think as we just designed this year, still in a challenging market and with a lot going on, we put some conservatism around that. I certainly think as you see the consumer stabilize and you see the activity that we have in the marketplace resonate and hopefully, we'll be targeting something in excess of that 50 basis points from the core.

David Barry

Yeah. I think that's fair, Mike. A couple of things I'd add, we still have China down about 30% in the first quarter. If you push that through Fortune, that's 25 to 40 basis points of headwind. That smooths out going forward, but it impacts the year. And then as we talked about, we're not pleased where core Security is. And there's still some work to do at the beginning part of the year to get that portfolio back performing and back performing above market, which we intend to fully do.

Michael Rehaut

Okay. No, those are fair points and appreciate the candor there. I guess, secondly, maybe just circling back to the tariffs for a moment. I believe, Dave, you just said that the China and potential Mexico tariffs are reflected in the guide. So what does that mean in terms of how we should think about volume versus price in that 0% to 3% guide?

I would assume that when you're trying to offset the impact of tariffs and it would appear that your guide is reflecting the ability to offset most, if not all, of the impact of tariffs that most companies, I think, kind of take a price-first, supply chain simultaneous, where you're not going to get the full impact of supply chain.

So I'd assume that there's some price in that guide and part of your view around being able to include tariffs in the guidance and maybe have a minimal impact. Maybe just if you could address some of those points there.

David Barry

Yeah. Let me clarify a couple of things. So the China impact of 10% is in--fully embedded in the guide. Our EPS range would cover Mexico and Canada, though bills go into effect. I think our sales and margin would look different, right? Because we would take more price to cover the dollars and margin would probably look a little bit different as a result of that.

So that two points, right? There's China fully in the guide, less than low single-digit price across the whole portfolio--or 1%, less than 1% price across the whole portfolio to cover Mexico, Canada. To your point, yes, we would expect to cover that impact through price and supply chain actions, but that hasn't been flowing through kind of the sales and margin piece because it's still uncertain.

Nicholas Fink

And as Dave said, very manageable price from what we see certainly today.

David Barry

Yeah. And actually, with the China piece, Mike, the removal of the de minimis exemption is actually an opportunity for us, right? I mean, we talked about these imposter brands and a lot of them are using that loophole to ship directly to our consumers in the U.S. If that goes away and stays, but that is an opportunity for our teams to take share.

Michael Rehaut

Great. Thanks so much.

David Barry

Thank you.

Operator

The next question comes from the line of Adam Baumgarten with Zelman & Associates. Please proceed.

Adam Baumgarten

Hey, everyone. Good evening. Just on gross margin, it really stepped up nicely in 2024 from '23. Can you maybe talk about the drivers behind that and how sustainable that is going forward?

David Barry

Yeah. And I'm happy to do it. It's been on a nice trend all year, right? And we talked about some of the actions we've taken, like closing our Milwaukee plant for Security to help boost our gross margins, our continuous improvement initiatives as a result of our new aligned supply chain, driving incremental sourcing and then some product mix benefits as the portfolio continues to shift to higher margin opportunities.

So we do think it is sustainable. I think it is the right jumping-off point as we look forward to '25. As I mentioned in my--talking through the guidance in the phasing, there'll be some lumpiness in the quarters

based on how some of our inventory is moving from the balance sheet into the P&L at a higher cost base, but that will even itself out through the year. As we look at the full year, we do expect gross margin expansion again in '25.

Adam Baumgarten

Okay. Great. And then just on the share repurchases, big authorization here. It looks like based on the guide and the share count that you're not building in any repurchases beyond maybe the January number that you gave. I guess, is that just conservatism? Do you still expect to repurchase shares in 2025 given the authorization?

David Barry

Yes. So I'd say consistent with our guiding practice, we put in share repurchase authorization to offset dilution. So that's what's in the guide. It's our intent to be aggressive when we see dislocations in our share price. We're generating a lot of cash and pursuing incremental opportunities to reduce our working capital.

We have some process improvements going into effect this quarter and looking at some other working capital initiatives to actually even accelerate our cash flow guide above and beyond where it is today. So we'll be aggressive when the opportunity exists to buy back shares and still be mindful of our leverage target. But I think given the cash generation, we're able to do that and still delever down towards where we want to be.

Nicholas Fink

Yeah. And I'll just add, to put a fine point on it, we're very focused on that cash generation, right? So this year, I mean, '24 are very pleased with cash generation over 100%, targeting in '25, it to be somewhere between 115% and 125%, right? So targeting \$600 million-ish.

As Dave said, there's some initiatives we have in mind that we think we can get even more out. And I think as Dave described the phasing of margins for the year, you'll see us be able to turn some inventory into cash earlier in the year. And while it has a short-term margin impact, that cash generation, particularly when we see dislocations, can be a very favorable thing. So we're very focused on it and we think it's something that we can use to really create shareholder value here.

Adam Baumgarten

Okay, great. Thanks.

Operator

The next question comes from the line of John Lovallo with UBS. Please proceed.

John Lovallo

Hey, guys. Thank you for taking my questions as well. Maybe the first one just on the CapEx outlook of \$100 million to \$140 million. I mean, that's down pretty meaningfully, obviously, year-over-year. It almost seems like it could be approaching kind of maintenance CapEx levels. Am I thinking about that correctly? And are you comfortable with the ability to continue investing in growth?

David Barry

Yeah. Yes, absolutely. So maintenance CapEx challenge for us is about 1% of sales, so call it, in that \$50 million range. So this would include growth capital. Why it's stepping down? As a reminder, we've put in incremental capacity over the past couple of years. And I think we've been clear that the CapEx rate of '23 and '24 were not the go-forward rate for this business.

As I said, we now have capacity and as volume comes back, we have more efficient, newer capacity in certain parts of the business, which will lever substantially through the P&L. But part of that strong cash flow generation is actually getting back to what is more like that 2% to 3% of sales CapEx rate, which is our longer-term target and still leaves us plenty of capital for growth. We're not starving the business for any growth initiatives by any stretch.

Nicholas Fink

Just to go a little bit further on that. I mean, just over the last few years, I've mentioned, I think in the remarks, we've opened, just in last year into this year, two new facilities for Water. We put more capacity into Outdoors. Obviously, with the footprint moves in Security, incremental capacity going in there, more (inaudible). So actually, the business is now really well capacitized (sp), and we're confident that over the next few years, we're going to be able to not just generate a lot of cash, but really grow into that capacity and leverage through it.

So from that perspective, I think we're actually in a really good spot. And the fact that we've been able to grow margins while doing this, I think, is a testament to how we've been leveraging the Fortune Brands Advantage across the entire company to be super efficient. We're deploying extra cash into capacity. We're deploying cash into things like digital and yet growing margins at the same time, which really sets us off as volumes come through to drive a lot leverage through the business.

John Lovallo

Okay. That's helpful. And then maybe just a point of clarification. I thought last year at this time, you guys had talked about digital sales kind of running at an annualized rate of \$250 million. I mean, in that context, the \$214 million that you guys printed in 2024 seems a bit light. So I wanted to ask that. And then just on the Flo portion, can you provide any more color on the other insurance company wins?

Nicholas Fink

Yeah. Why don't I start and give a few more specifics. I'd say, firstly, on the dollar, we wanted to sort of give it for the year. And then as we progress through '25, we'll tell you what the run rate is.

Flo, performing as we said, exceptionally well. The cLOTO business now coming online. And then Yale, sort of interesting as we integrated that business and brought it on board. As we've always said, sort of mid-cycle start-up, and it kind of acts like it. So they signed big partnerships. So I think we said 14 in 2024. But then you also exit old products, you exit old partnerships, and so there is choppiness in the number, and we saw a lot of that choppiness in '24, frankly, where it actually went backwards. But as the 14 new partnerships ramp, then it returns to growth.

I think part of our objective for that business needs to be we need to smooth that out, which we will do by maintaining and building those B2B partnerships but also building out more of a B2C business as we have in Flo. So you have, as we do in Flo, so the B2B insurance, you have the B2C business and you get much,

much smoother ramp. So that choppiness in the number, but I'd say, if you step back from that and you look at what we're signing up and you look at what's going in, we're absolutely delighted with it.

And then from the insurance partnership perspective, there are a variety of flavors from affiliates recommended, to discounts, to mandates. The reason we talk a lot of our Farmers and the reason we think Farmers is a milestone deal is really it was the first where an insurer says, this is mandated for a certain subset of homes. If you want to continue to insure this, we have to take cost out of the system, you have to put the product in.

We continue to sign up insurers of all three types and we'll continue to do that and watch it ramp. I think you'll see more happen and it's somewhat regulatory where it can happen, but I think you'll see more happen in both the discount as well as the mandate.

The other thing that we talked about we're going to start trialing in this quarter is a subscription recurring revenue model around this business, which we think will make it much, much easier not just for those consumers to absorb the cost, but also for the insurer to mandate it because the entry-level price point, if you will, will be a much, much lower number than the cost of installing a device from the get-go. I will tell you the financials actually work out much better for us in the long run because you develop lifetime customers and the lifetime value of those customers are far greater than a single one-time sale, but we view that as the next big milestone step forward in bringing these partnerships to life.

John Lovallo

Great. Thank you.

Nicholas Fink

Sure.

Operator

Thank you. This concludes our Q&A session, and this concludes today's conference as well. You may disconnect your lines at this time, and enjoy the rest of your day.