Fortune Brands Home and Security, Inc. (FBHS) CEO Chris Klein on Q3 2019 Results - Earnings Call Transcript

Oct. 24, 2019 1:38 PM ET
by: SA Transcripts

Q3: 10-23-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $0.95 misses by $-0.03 | Revenue of $1.46B (5.66% Y/Y) misses by $-28.07M

Earning Call Audio

Subscribers Only

0:00:00 -1:01:59

Fortune Brands Home and Security, Inc. (NYSE:FBHS) Q3 2019 Results Conference Call October 23, 2019 4:30 PM ET

Company Participants

Brian Lantz - Senior Vice President of Communications and Corporate Administration

Chris Klein - Chief Executive Officer

Nick Fink - President and Chief Operating Officer

Pat Hallinan - Chief Financial Officer

Conference Call Participants

Michael Dahl - RBC Capital Markets

Tim Wojs - Baird

Phil Non-GAAP - Jefferies

Justin Speer - Zelman & Associates

Michael Rehaut - JPMorgan

Operator

Good afternoon. My name is Josh, and I will be your conference operator today. At this time, I would like to welcome everyone to Fortune Brands' Third Quarter 2019 Earnings Conference Call. [Operator Instructions] After the speakers' remarks there will be a question and answer session. [Operator Instructions] Thank you.

I would like to turn the call over to Mr. Brian Lantz, Senior Vice President of Communications and Corporate Administration. You may begin your call.

Brian Lantz

Good afternoon, everyone, and welcome to the Fortune Brands Home & Security quarterly investor conference call and webcast. We are pleased to be here today to provide an update on our progress during the third quarter of 2019. Hopefully, everyone has had a chance to review the news release issued earlier. The news release and the audio replay of the webcast of this call can be found in the Investors section of our fbhs.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 our 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 such as our annual report on 10-K. The company does not undertake to update or revise any forward-looking statements, which speak only to the time at which they are made. Any references to operating profit, earnings per share or cash flow on today's call will focus on our results on a "before charges and gains" basis unless otherwise specified.

With me on the call today are Chris Klein, our Chief Executive Officer; Nick Fink, our President and Chief Operating Officer; and Pat Hallinan, our Chief Financial Officer. Following our prepared remarks, we've allowed some time to address questions that you may have.

I'll now turn the call over to Chris.

Chris Klein

Thank you, Brian, and thanks to everyone for joining us today.

In the third quarter, our teams continued to execute against our growth strategies and manage the effects of tariffs. We delivered solid results as sales grew 6% and operating margin improved.

I'm particularly proud of our team's performance year-to-date. In 2019, we have experienced a housing market that was slower in recovering than we initially planned as well as a variety of other external pressures, most significantly higher levels of tariffs. And we've been overcoming these challenges and delivering solid performance with year-to-date sales also growing 6% and operating margin expanding.

Growth initiatives across plumbing, value price cabinetry and decking have been top priorities, and the funding of these areas is delivering top line growth today and will fuel 2020 as well. A multi-disciplined effort across our supply chain teams, our legal teams and our pricing teams is working to offset the ever-changing tariff landscape. Taken together, the performance this year is truly impressive.

So I'll first take you through our view of the US home products market. Next, I'll turn the call over to Nick, our President and Chief Operating Officer. He will share highlights of the more aggressive actions he's taking across the business to strengthen the company for our next phase of growth, especially as he prepares to assume the CEO role in January. Then, he will share his perspective on our business performance in the third quarter. Finally, Pat will provide more detail on our third quarter results and 2019 outlook.

Starting with our updated view of the US home products market. As I mentioned, in the third quarter, the market continued to be slow, but began to pick up in September and is now improving in October. Currently, we are seeing more sustained momentum from both new construction and repair and remodel markets. The data is now pointing to the modest pickup in growth that we had expected earlier in the year with healthier order rates in September and into October that should continue.

In the third quarter, we estimate that the market for our products grew 2% with the repair and remodel market growing around 2% to 3%. New construction spending on our product categories was approximately flat to down slightly. The ramp-up in new construction activity that is starting now, coupled with a modest pickup in existing housing sales, should translate into a healthier market over the next year. These market dynamics, combined with the tailwind in cabinets from the recently announced antidumping duties against Chinese cabinet manufacturers, gives us optimism about the fourth quarter and 2020.

In a moment, I'll turn the call over to Nick Fink, our incoming CEO in January 2020. As I've said before, the Board and I have confidence in him as a great partner and leader. He has a proven track record of success with leading brands both here and in previous roles. Nick built out our Global Plumbing Group platform to be a multi-brand channel and geography powerhouse. The platform has consistently delivered above-market growth at industry-leading margins. He built strong iconic brands, including the rejuvenation of the core Moen brand and the establishment of the House of ROHL while bringing innovation into the market through acquisitions and strategic partnerships. Since becoming President and COO earlier this year, he's been focused on bringing his winning approach to our other businesses, working closely across our segments and leadership teams to identify areas of opportunity. He has also led the successful navigation of a challenging tariffs period, repositioning supply chains and managing pricing strategies across all segments of the business.

I'll now turn the call over to Nick, who will provide some additional color on his efforts across the businesses and discuss our third quarter performance.

Nick Fink

Thanks, Chris. As Chris mentioned, we have many opportunities ahead of us. We are laser focused on investing in and capturing the most promising of these opportunities. Additionally, we've worked hard to successfully manage through the continually evolving tariff environment, which has required us to allocate supply chain and cross-functional resources temporarily away from our planned efficiency improvement efforts.

We continue to build upon our growth in our Global Plumbing Group, which is now more than half of our total company profit. We will continue to be successful in re-energizing the core GPG brand, Moen, behind our hero for beautiful water campaign, which is already showing remarkable results.

We're driving consumer-relevant innovation in core faucet and shower categories as well as new categories. We're leveraging channel partnerships and key customer management and we're building our growth engines in China, digital water and M&A and partnerships.

In outdoor living, we are focused on the expansion of Fiberon Decking. We're building a strong consumer brand and competitor in the market. We're investing in the business in additional expansion opportunities and we're executing against substantial wins to date.

Early in the third quarter, we announced that Fiberon will expand distribution significantly across the West and Southwest through OrePac Building Products, in addition to other significant multistate distributors such as Wolf in the Northeast, Weekes Forest Products across the Upper Midwest and Coastal Forest Products in the Southeast. Coverage and distribution through OrePac provides an opportunity for Fiberon to leverage these strong, existing relationships as both of our businesses seek additional opportunities for growth in outdoor living in 2020 and beyond.

We're also making continued progress on a more aggressive Cabinets pivot plan to transform this business. Let me take a minute to tell you about the latest big step in our Cabinets transformation, the planned retirement of Cabinets President, Dave Randich, and the orderly transition to a new incoming President, Dave Banyard, on November 18.

We are incredibly excited that Dave Banyard has decided to come on board to lead this business into a new era of growth. We are impressed with his accomplishments and his tremendous passion for transforming businesses and delivering improved performance. I've spent time getting to know Dave and his leadership style, approach to business and deep level of integrity are a great fit for our culture and our teams.

Additionally, with his wealth of global manufacturing, operations and commercial leadership experience, coupled with a proven track record of executing, we believe he will be successful in capturing growth and margin improvement in this business. Our teams are excited and preparing for his first day in a few weeks, and I know he'll hit the ground running. We wish Dave Randich all the best and thank him for his over 12 years of service with the company, including the last 7 years at MasterBrand Cabinets where he significantly grew and transformed the business.

So now let me turn to our results for the third quarter where we continued to execute against our initiatives and had solid sales and profit results. In the quarter, total company sales increased 6% and operating margin was up slightly to 13.9%. This was a solid result in light of a softer market than we expected, tariffs and other external pressures and investments we've made for future growth. Overall, our performance in the quarter was helped by the result of rigorous expense control across the businesses while we continue to make investments to support our growth opportunities. We will continue to take steps to outperform a more moderately growing market and offset tariffs and other external pressures, including transforming our supply chain, taking price, launching innovation, expanding and growing categories and channels and integrating acquisitions and partnerships.

So turning to the segments beginning with Plumbing. In the third quarter, the Global Plumbing Group continued to outperform the market with sales growth excluding FX of over 12% and operating margin of 21.8%. Growth was driven by above-market POS in the U.S. and strong double-digit growth in China, where we continued to expand our product offering and take share. Continued strong performance in our core markets more than offset continued softness in the Canadian housing market. Our re-energized Moen brand is showing increased awareness, loyalty and purchase intent as well as continued share gains. We will also continue to build momentum through product innovation and partnerships, such as U by Moen, Flo by Moen and Elkay. These innovations and partnerships are helping to expand our portfolio and are allowing us to convert customers and drive gains in distribution.

In Cabinets, sales were down 2%, flat in the U.S., and operating margin was 10%. Sales in the targeted value price part of the market, which is now approaching 50% of our business, were up mid-single digits in the quarter as we continue to have success and take share. Sales of higher price point, made-to-order cabinets contracted in the mid-single-digit range. As part of the more aggressive pivot, we are accelerating cost-out initiatives by continuing to ramp up our value price capacity and tightening capacity for semi-custom products. We are leveraging our Mexico and other low-cost country supply chain to deliver even more value price products while maintaining the service and quality our valuable dealer network expects from us.

As antidumping duties come into effect in addition to the existing 301 tariffs, we have been aggressively launching consumer-facing innovations in our Mantra, UVE, Aristokraft and Urbana lines across our 4,500 industry-leading kitchen and bath dealers. This new higher margin yet value price suite of products addresses the increasingly strong demand our customers are seeing from consumers. We will fill the void and take back share as Chinese products begin to pull back from the market, a trend that should continue through 2020.

Our retail bath and kitchen in-stock programs are also expanding in home centers along with more significant online presence. Margin performance, in light of all of our actions, is encouraging even as we continue to navigate the near-term inefficiency due to the large-scale transformation to the manufacturing footprint and the supply network.

In the quarter, Doors & Security sales increased 11% and operating margin was 14.5%. Doors POS performance was up while managing through a significant retail inventory rebalancing versus the strong comp last year and the lag to recently improving new construction activity. In decking, due to our program wins earlier in the year, we continue to accelerate investment to capitalize on growth opportunities that will begin to be realized in the fourth quarter and more significantly into 2020.

And in Security, the team continues to work towards closing the gap on the tariff impact with cost and price actions. The Master Lock brand is on track with improved product quality and service levels, and we expect to see stronger growth beginning in the fourth quarter as price increases take effect in order to help offset tariffs.

To wrap up, as I look across our businesses, I'm incredibly pleased with our results and performance. I'm impressed with the challenges we've overcome and the progress we've made on our strategic initiatives this quarter and throughout the year. Outperforming the market as we have done in the past takes even more resolve and teamwork in this environment of more moderate growth. I see our teams embrace these challenges with passion and ingenuity every single day.

Looking ahead, we have vast opportunities both within and across the businesses. The initiatives that we've taken and investments made in 2019 which are delivering results set us up to accelerate even faster as growth returns in 2020. We continue to collaborate, innovate and leverage our strengths. All of these efforts set us up to win and create even more value.

I will now turn the call over to Pat.

Pat Hallinan

Thanks, Nick. As a reminder, the majority of my comments will focus on income before charges and gains in order to best reflect ongoing business performance. Let me start with our third quarter results.

Sales were $1.46 billion, up 6% from a year ago and 3% on an organic basis, excluding Fiberon and FX. Consolidated operating income for the quarter was $203 million, up 7% or $13 million compared to the same quarter last year. Total company operating margin was up slightly to 13.9%. We remain on track to achieve our goal of around 50 basis points of full year operating margin improvement despite market softness and tariff pressures that have been more challenging than those in our plan or in our revised second quarter guidance. EPS were $0.95 for the quarter versus $0.93 for the same quarter last year. We are pleased by our team's continued ability to grow sales and earnings during a period of softer market growth, the persistence of a challenging trade environment and while navigating significant supply chain transitions in a number of our businesses.

Now let me provide more color on our segment results, beginning with Plumbing. Sales for the third quarter were $514 million, up $53 million or 11%. Excluding currency, sales increased 12%. When also excluding the comp to last year's hurricane impact, sales were up over 8% in the quarter. Continued strong double-digit growth in China and solid U.S. POS drove the quarter with reported sales results slightly muted by Canadian housing market weakness.

Plumbing operating income increased 20% to $112 million. Operating margin was 21.8%, an excellent result driven by cost discipline and sales growth leverage in the US and China. We continue to be on track with our full year outlook in Plumbing with sales up in the mid to high single digit range and with operating margin around 21%.

Doors & Security sales were $355 million, up $35 million or 11% from the prior year quarter driven by Fiberon. Door sales were flat and impacted by a lag to the soft yet improving third quarter US new construction market and a significant inventory rebalancing, especially in retail. Security sales were down in the quarter due to international market softness and commercial channel timing. We are expecting Security sales to increase double digits in the fourth quarter due to commercial project timing and favorable comps to last year's service issues.

Operating income was flat at $52 million. Income performance was muted by a price-to-tariff lag in Security, the mix associated with the retail inventory rebalancing and a strong comp to last year and lack of volume leverage in Doors & Security. Versus the prior year, we expect Doors & Security operating income to improve considerably during the fourth quarter due to cost actions taken during the third quarter, Security tariff pricing going into effect, volume leverage as new construction demand resumes and comps to Security's 2018 service issues. For the segment, we are on track to deliver mid-teen sales growth in the full year and operating margin above 13%.

Turning to Cabinet. Sales for the third quarter were $590 million or down 2% versus the prior year quarter. Sales in the US were flat. As Nick said, sales of value price products in the U.S. were up mid-single digits while sales of mid to higher price point products were down mid-single digits.

Operating income in the third quarter was $59 million, down $6 million versus the prior year. And operating margin was 10%, consistent with our full year target. We expect Cabinet operating margin improvement in the fourth quarter driven by incremental cost actions taken during the third quarter and market-driven volume improvement. For the full year, we expect total Cabinet sales to be flat while up slightly in the U.S. full year operating margin is expected to be around 10%.

For the total company, to sum up third quarter performance, sales increased 6%. EPS grew to $0.95, demonstrating our ability to execute and drive growth and margin improvement in a slower tariff-challenged market. Our total company operating margin was up slightly to 13.9%. We should benefit from the financial discipline and expense control we executed year-to-date as the housing market gradually improves.

Before turning to the balance sheet, I want to take a moment to provide perspective on our numerous tariff recovery efforts and the impact on the business. We continue to mitigate the impact of current tariffs through a mix of supplier cost sharing, shifts in geography and other actions including pricing. Through this combination of actions, we were able to offset roughly $15 million of gross tariff exposure in the quarter and expect to offset around $55 million for the full year.

Turning to the balance sheet. Our balance sheet remains solid with cash of $336 million, net debt of $2 billion, and our net debt-to-EBITDA leverage is 2.2x. We continue to have the capacity and flexibility to fund potential acquisitions and share repurchases as we delever naturally during the second half and over time.

During the quarter, we priced an offering of $700 million of senior unsecured notes maturing in 2029 at 3.25% and maintained our solid investment-grade rating. The company refinanced its $1.25 billion revolving credit facility in September. With a longer duration across our debt structure at attractive interest rates, we have the liquidity to invest for growth both organically and inorganically.

During the quarter, we repurchased 1 million shares for approximately $50 million, bringing the year-to-date share purchase total to 2 million shares for approximately $100 million. We have $314 million remaining on our current share repurchase authorization.

Turning to the details of our outlook for 2019. Based on the market for our products growing 2% to 2.5%, we have tightened the range of expected full year sales growth to 5% to 6%. As a result, we now expect EPS within the range of $3.53 to $3.63. As we've seen the market begin to pick up in September and October, we are also encouraged by the momentum of our Plumbing business in the U.S. and China, the continued demand strength in the market segments to which we are pivoting our Cabinet business and Fiberon's distribution gain.

We expect 2019 free cash flow of approximately $480 million to $500 million, which includes the accelerated investments in capacity and inventory to support new composite decking customers. We anticipate a cash conversion rate at or above 95%. At year-end, we expect net debt-to-EBITDA to be 2.0x versus 2.4x in the prior year.

The annual EPS outlook includes the following assumptions: interest rate expense of around $94 million, a tax rate between 25% and 26%, and average fully diluted shares of approximately 141 million.

In summary, our teams are executing well in an improving market and are making progress on our strategic initiatives, which should better reflect in our results in the fourth quarter and next year.

I will now pass the call back to Chris for some closing remarks.

Chris Klein

Thank you, Pat. Before we begin the Q&A session, I have a few final thoughts. In early 2009, I began leading the Home and Hardware division of Fortune Brands. 8 years ago, in October of 2011, we spun off as our own independent company, FBHS. Over the past 11 years, we've restructured businesses, greatly expanded through innovation and penetration of new markets and made changes in the portfolio of businesses we operate. Most significantly, we have built great teams around our unique and powerful culture.

As I look out into the balance of 2019 and 2020, I see an improving home products market. We have positioned our businesses with enhanced supply chains and cost structures and have funded growth opportunities to ensure we prosper in this improving market.

January of 2020 is an ideal time for me to transition from CEO to Executive Chairman and for Nick Fink to take the reins as our new CEO. He inherits a great team and a great set of businesses and opportunities, and I know the transition will go smoothly. I am excited for this next chapter of our company's growth.

With that, I will now pass the call back to Brian.

Brian Lantz

Thanks, Chris. That concludes our prepared remarks on the third quarter of 2019. We will now begin to take a limited number of questions. [Operator Instructions]

I will now turn the call back over to the operator to begin the question-and-answer session. Operator?

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from Michael Dahl with RBC Capital Markets.

Michael Dahl

First question, I guess just big picture, you guys have had a lot of change, Chris, with your transition and now the change in Cabinets. And I guess I want to focus specifically on Cabinets and Dave coming in and transition there. And I appreciate your comments around the moving pieces, but from the outside looking in, I think a lot of people see these last couple of quarters sales growth stall out a little, margins backtrack. Clearly, there's some investment going on underneath all of this in the pivot, but now you have a new -- a change in leadership. It causes a lot of -- it drives a lot of questions. So just hoping you can elaborate a little more on the changes that you're making there, Dave's goals coming in and just what you can give us as far as incremental confidence that the Cabinets pivot will ultimately pay off in terms of margin progression and getting the growth back on track.

Chris Klein

Sure. Yes. There's a lot there in that question. I'd say the progress of the plan overall is on track. And if anything, we accelerated this year in terms of investment in capacity in our supply chains supporting the value part of the market. And there, we've put up consistent growth, single digits, high single digits, low double digits growth really throughout the last 4, 5 quarters. On the other side of the market, we've been talking about across KCMA, have been candid about weaker semi-custom premium volumes in the marketplace. So that is all going to plan. I think our restructuring capacity is on track. I'll have Nick give a little bit more detail.

In terms of Dave's transition and frankly my transition, we focus on succession pretty rigorously. And if you look across kind of the last 5 to 8 years, the transition in my leadership team has been pretty continuous as people have retired or moved along and we've brought in new talent. And so there's no real event or catalyst around Dave Randich. Dave has done an outstanding job. He indicated his desire to retire and so we began looking for his replacement. And so understand there's a lot of moving pieces. But in terms of where the Cabinet business is going, we actually think we're at a pretty interesting inflection point right now and are pretty optimistic. And maybe, Nick, you could give a little bit more detail on that.

Nick Fink

Sure. I'd be happy to, Chris. First, I'd start with just steady performance in the quarter, flat in the US in a declining market. So you're seeing share gains come through at a 10% margin, which is exactly what we were targeting for the year. But for inefficiencies that we had as we ramped some of our value capacity even faster than we expected, we would have hit a margin even higher than that. And so all of that sort of point to some really positive momentum. And then I think you layer on that some new products that we're bringing into the market that are exceeding our expectations at that value price point, both through our home center partners, I'll touch on in a second, and through dealer partners. Yes, in home center, so just yesterday, Home Depot, one of our key retail partners, recognized us by naming us as their kitchen and bath supplier partner of the year. So a credit to what they're seeing us do. And in dealer, we've launch a new product with Mantra

Omni as well as Aristokraft and Urbana lines, all targeting that part of the marketplace. And I'll tell you Mantra is surpassing our expectations by quite a lot. So pivot by no means done, but a lot of the changes are really well underway.

And then against that backdrop, Dave Randich has been with the company 12 years, 7 years leading this business. He indicated in the spring a desire to retire which kicked off for us a succession plan. And we're delighted that we were able to attract a candidate as outstanding as Dave Banyard, who's going to come here and bring his passion for transforming businesses and delivering improved performance to us at a time when we really think that we're going to see incremental growth come as the Chinese manufacturers retreat. We're already seeing that pretty significantly through the import numbers. And we're targeted right at that sweet spot in the market. And we've got 25% share, our position in dealer and our position in home center very well situated to pick up that incremental volume.

Michael Dahl

My second question...

ChrisKlein

Did we get it all? Did we get it all?

Michael Dahl

There's always more. Second one, shifting gears, Plumbing, clearly, another standout quarter there and especially where I think we've seen some other indicators that would suggest the market growth was somewhat subdued in the quarter. So just I guess heard the comments about China, but just a little more detail on what exactly is driving the significant outperformance on the top line. Was there any load-in benefit? How should we think about the next couple of quarters, particularly as I think the fourth quarter guide, if you're really going down to the 21% operating margin for the full year might suggest some deceleration but maybe just clarify that.

Nick Fink

Sure. And I'll be happy to. Okay. Let's start with overall performance. The group grew over 12% adjusted for FX at a 21.8% margin, so obviously some pretty stellar performance. What I'll say is, we're continuing to build upon that group, which now represent more than half of total company profit with more to come.

So if the question is sort of, what's driving that? I'd step back and say, we're now a couple of years into re-energizing the core Moen brand and it's really firing on all cylinders. The brand is being powered by twin engines of brand building and innovation. And so our hero for beautiful water campaign which we launched last year is driving increased awareness, loyalty and purchase intent. We're seeing those metrics come through really strongly. That's translating into continued share gains and we're seeing some great results there. And then we've launched some really consumer-relevant innovation, both in the core as well as some new categories, and that's driving excitement with other consumers and our customers. That's true both across the core market in the U.S. where we're outperforming and our business in China. And through that, we're continuing to leverage all our channel partnerships and key customer management.

Layering on top of that, we're still building out more growth engines, China, digital water, luxury plumbing and through our partnerships. And so I would say, if you ask how we feel about it, despite multiple years of market-leading performance at these margins, we're confident we're still just getting rolling in Plumbing. The best is yet to come. And so we're continuing to invest behind the brand.

And as far as the question about inventory is concerned, I would say, it's actually pretty lean and it's been lean throughout the year as we've seen our wholesale partners navigate pretty conservatively. And so, if anything, we think Plumbing would be poised for acceleration as the market comes back and that pipeline has to fill again to serve that demand.

Operator

Your next question comes from Tim Wojs with Baird.

TimWojs

So I guess maybe first question just on the cabinet market, just trying to think of how you think it evolves next year with the tariffs and the dumping duties on China. Just how much of the Chinese share do you think actually can come back to the U.S. manufacturers or again, how are you kind of thinking about it from a planning perspective?

ChrisKlein

Yes. Probably in the range of 12%, 13%, I think, is where most industry analysts estimate it at and it's really drying up. So you can see it in the import data, but we're on the ground and have moved all of our suppliers out. And the shipments out of China have really stalled. So I think it opens up the market for those who are leaders in the market today. Nick can talk to you a little bit about some of the things that we're positioned against. But we're 1/4 of the market and one of the powerhouse in dealer and a lot of this was flowing right through dealer. And so our pivot plan has preserved those dealerships. And some have suggested we could have gone faster. And I'd say, we could have gone faster and we could have blown up our dealer relationships but we didn't. We could have gone faster and we could have diminished our service levels to the home center but we didn't.

And so now as volume comes back and China dries up, we're in a terrific position to capture it. We're trying to estimate it. We've got capacity to be able to service it. And Nick will talk to you about a lot of the products that we've launched and are coming into the market. We'll quantify in January, but suffice to say, we're pretty optimistic about it. And in the core market through new construction, R&R picking up, in addition to some of the Chinese or really a good part of the Chinese manufacturer volume coming in drying up, we're going to be in a good spot. So maybe Nick, you can just talk a little bit about some of the things that we've launched and really what we're anticipating.

Nick Fink

Sure. Sure. I'd start by noting, these tariffs and duties are already in effect, right? And so the Chinese manufacturers have to go premium. And I think that's why you're seeing such a precipitous drop-off in these volumes. All that being said, we're not dependent on government action. And so independent of that, we've been building out our Mexico and low-cost country supply chain and we've been launching products into this part of the marketplace where we believe we could succeed, duties or no duties. And Mantra and the success of Mantra is a great example of that. All that said, now that duties are already included with imports dropping off, we have the supply chain in place, we have the suite of products right at the heart of this market, already in-market and accelerating, more launching. And so we think we're really well positioned. Again, we're 25% share. We got the right supply chain that we believe is competitive anyway and the right suite of products. And so as we sort of turn the corner here into 2020, we think this could be a really material tailwind for the business.

TimWojs

Okay. Okay. I appreciate all that color. And then on tariffs, just is there a way to just talk about what your exposure to List 4 looks like and maybe what kind of looking out to 2020 if you snap the line, what the total gross exposure to tariffs looks like next year?

Pat Hallinan

Yes. Our exposure to tariff this year, and this is a tariff expense, is $55 million this year. We would expect to fully offset that. Next year, as we go forward, we're always working cost actions to try and take things off the list. But of course, we'll be anniversary-ing next year more months of List 4 and more months of List 3 being at 25%. And we would expect next year, Tim, to also have about $50 million of tariff expense exposure. But I would say the increase of List 3 was about as big an impact as the addition of List 4, and Plumbing is about 60% of the total tariff picture.

TimWojs

Okay. Okay. So about a $50 million kind of incremental gross expense next year that you think you can offset?

Pat Hallinan

Well, I wouldn't call it incremental, it's just a continuation. Again, I'm giving you this year. We'll pay tariffs of about $55 million. Next year, if there's no further cost actions which, of course, there will be some more further cost actions. Where we sit right now, we would expect to pay about $50 million of tariff expense. So it would actually go down a little bit year-over-year, think of it as run rate neutral.

Operator

Your next question comes from Phil Ng with Jefferies.

Phil Ng

Appreciating R&R and housing has been a little more choppier, but I guess on your last call, kind of indicated market conditions firmed up in June, July, but the top line was obviously a touch weaker. How confident are you in terms of the trends you saw in September and October provides you a good line of sight things are going to pick up in the fourth quarter and positions you well for 2020?

Chris Klein

Yes. So I'd say coming out of July, we're hopeful things would accelerate into August. They really didn't. September, there was a noticeable difference. So our performance in September, which is in the numbers we just reported in the third quarter, was much stronger than July, August. And in October, order rates are continuing at a much improved rate, and that's across the whole business. I think not surprising, we are pretty exposed on new construction, which is a good thing when new construction starts picking back up again. So you saw both public builders and we see the private, order rates that are increasing significantly. And that's starting to translate through permits and starts. And we've got pretty lean inventories across most of the channels that we're selling into. So given our share positions in plumbing, cabinets, entry doors, exposed to new construction, we're starting to see that pick up flow through. And R&R, it improved this fall relative to where we were in the spring, in the summer. Maybe you can give a little bit of kind of what we're seeing inside of the businesses, Nick.

Nick Fink

Yes. I would say through the spring, there were a couple of spurts, but ultimately the summer was very quiet and I think that's not surprising given the weather that we saw in Q2 translates through to Q3 for us. September was a noticeable step change in that. And it was very consistent across the portfolio. And so we saw it across all of our businesses. We saw it particularly also in the wholesale channel, which is a great bellwether for the health of the market as our wholesalers going to start to serve that inventory and in the parts of the business that are serving new construction market as well. And it really dovetails with what we're seeing in the macro data. Even in areas which is most exposed to new construction amongst our businesses, we saw positive point of sale across the quarter. And that was largely through a big pickup in September. And so this feels like a much more solid step change than some of the spurts earlier in the year.

Phil Ng

Got it. And then your results in your Doors & Security business, more Security than Doors, have been a bit uneven in the last 18 months or so. How confident are you in getting back on track in the fourth quarter? And tariffs obviously has been a headwind for Security. How are you going to plan to manage it a little more effectively going into next year because you still have some incremental tariffs coming in?

Pat Hallinan

Yes. That's fair. That business does need to perform more evenly. That would be consistent with its demand profile. First of all, the operating challenges that we had last year have been fully behind us this whole year. And so now it's a matter of 2 things. One, regaining the confidence of our customers which we're on a path to do. And this is the one part of our business that has lagged in performance relative to tariff inflation. So that business going into the fourth quarter does have tariff pricing in place. That's a good progress. It will have about $7 million of favorable comps as we head into the fourth quarter, OI comp. And then as it goes into next year, it's about regaining the confidence of customers to put the spin back on the top line. There's good commercial project heading into the fourth quarter of this year. So our confidence around the fourth quarter of this year is around incremental cost actions taken in that business, tariff pricing and project timing in the commercial part of the business. But we're confident going into 2020 that, that business will continue to leverage its strong brand.

Chris Klein

And the Doors business has performed well. I think there is a channel inventory leaning out across both retail and wholesale. That business is heavily exposed to new construction. If you factor those 2 things in, it continues to perform very well at the market level. And as we see inflection up in new construction on the Therma-Tru side, we're going to see the benefit of that in the fourth quarter. It's got a pretty good momentum going into the year. So we're pretty happy with where that business is. And of course, Fiberon is also in that segment. So you see the effect of us investing in that segment ahead of all the demand that we've got coming at us through our distribution expansion, so that's going to roll together.

Operator

Your next question comes from Justin Speer with Zelman & Associates.

Justin Speer

And congratulations to you Chris and Nick on your new roles.

Chris Klein

Thank you.

Nick Fink

Thank you.

Justin Speer

I had a big-picture question for you, Nick, and just kind of stepping back and thinking about your view of the portfolio, your midterm targets. If you could step back and maybe give an appraisal of where you think the largest areas for value creation are that maybe aren't well understood by the marketplace.

Nick Fink

Sure. I'd be happy to. Thank you for the question. First, I'll start by just saying I'm honored to have the opportunity to continue to be part of building what is really a great company. If

I step back in this role as COO since March, have been working across the segments and looking at additional areas of opportunities that we've got. And what I'm going to do is continue to ensure that we invest in and capture the most exciting of those opportunities.

I'll start with GPG where, as I said earlier, we're going to continue to drive that growth in both our core North American Moen business as well as new horizons like whole home water and continuing to build upon our China business in a very sustainable and profitable way. So a huge opportunity there and more portfolio opportunity as we do things like bring our new House of ROHL concept into market as I spelled out at the start of the year.

The other great exciting spot I think that we haven't quite captured yet is outdoor living opportunity. It's enormous and we're really focused on the expansion of the Fiberon business. As a reminder, share of Weekes is still 82%. And so the opportunity out there is really big. And we're really set on building a strong consumer brand and a competitor in this marketplace that will benefit from these conversion tailwinds as they come on. As you think about it, we start from a really exciting position. Our strength is in value price products. And so we have an opportunity to move actually up the price spectrum. And we're supporting that through our expansion into wholesale, which will support not just the wholesale channel, but it also supports special order retail because special order retail is served through wholesalers. And so that's a second big area where we can really continue to execute upon our substantial wins to date. And you're going to see us investing and adding capacity in order to serve that.

And then I am excited about the progress in our Cabinets pivot plan as we touched on earlier. We're certainly in the back half of that. The steps are, while they remain many, they're actually well underway. And we are moving now to a set of growth initiatives coming off of this advantaged supply chain and we're already seeing progress against those growth initiatives in the marketplace.

And so those are the three big areas. Stepping back a little bit, I'd say, we'll continue to execute upon the strategies we talked about at our Investor Day in February. And as we always have, we're going to continue to stay a step ahead by really evaluating the marketplace and the changes that are coming at us and developing new strategies over time. And then finally to sort of add to that, what Pat talked about, with a pretty robust balance sheet and opportunities for capital deployment, I think you sum all that together and we're feeling pretty excited about what we're coming into in 2020 and beyond.

Justin Speer

That's helpful. And I guess as a follow-up to that, just thinking about these growth investments, you got some investments in the pivot strategy that you're saying is accelerating. And you have some growth investments in the Doors & Security business. And I looked at your full year guidance and that implies kind of an atypical step-up or maybe sequentially stable margin from the third quarter, which is atypically it's kind of a pullback. And I'm just curious how much growth investment took place, if you can maybe unpack that for us for Doors & Security that maybe was underutilized or that maybe doesn't repeat as we think about the go-forward plan.

Pat Hallinan

Yes. Justin, it'd be easier to get your head wrapped around it first thinking about the fourth quarter and then I'll come back to the third quarter because it's much about third quarter investment as it is about some of the transition inefficiencies.

You look at the fourth quarter, you're right. Typically, our margin profile throughout the year as a business, and this is typical of building products is, the second and the third quarters are the highest margin percentages and the shoulders are the lower margin percentages. And your math is correct. This year, the fourth quarter will be among our stronger quarters and be atypically high relative to the second and the third quarter.

To hit the midpoint of our guidance takes a bit more than $28 million of pretax operating income. And right away, we get about $10 million of that comping against both Fiberon purchase accounting and Security service issues from last year. So you get $10 million on comps. You get about $5 million from Plumbing continuing its performance momentum, very much in line with the order rate it's seeing and the cost structure it's been deploying. And then the balance of that performance comes both from Cabinets and the Doors & Security segment. And you look at what those businesses are doing. All 3 of those businesses, Doors, Security and Cabinets took incremental cost actions in the third businesses, Doors, Security and Cabinets took incremental cost actions in the third quarter that will play out in the fourth quarter. Security got tariff pricing and you have new construction coming back, which benefits the volumes in Doors and Cabinets, then you have some commercial project timing in Security. So we're feeling good about where the fourth quarter plays out.

And you're right, it's an atypical rhythm to the quarter. We always knew that this year we'd be absorbing some things in the second and the third quarters that were not typically in our margin profile. We're pivoting our wood product supply chain completely out of China this year. That's forcing us to digest some supply chain inefficiencies and some both tariff and duty goods in the Cabinets business as we do this. We're ramping up 3 plants in Cabinets as we work to both absorb the growth of the Mantra product line and prepare for some plant rationalization going forward. And so those are the types of things that we're digesting in the middle of the year that put pressure on our second and third quarter margins. So we feel good about where we are in the fourth quarter. Yes, it's a stout quarter, but we're all focused on delivering it and we could see a pathway there.

Nick Fink

From a big picture, the way we approach the year and the way we approach quite generally as we're here to create long-term shareholder value. And so as we came into this year, we focused on really, really rigorous expense control while prioritizing key investments that were going to deliver growth over the medium term. And so seeing that come through in the top line that was 6%, 3% organic at improving margins, which is not particularly easy in a tough market, but also some external pressures like tariffs coming at you. But through that, prioritized investments like Moen brand, like Fiberon expansion, like value price point cabinet, all things that are going to continue to drive growth as we come into the next year, particularly we've got a little bit of a tailwind from the market with this sort of re-based expense base that we have with these cost control in these investments. They couple really, really nicely to deliver growth for us.

Operator

Your next question comes from Michael Rehaut of JPMorgan.

Michael Rehaut

Michael Rehaut

Congrats, Nick, on the promotion. Chris, it's been great working with you. You're not leaving, but maybe taking a step back from the public role.

I have one more granular question and one bigger picture question. Maybe just to start on the granular side, I know you had a couple of questions around this earlier, but I just want to try and build on, if I could, and get a little bit more specific if you're willing.

In terms of a little bit of growth deceleration from 2Q to 3Q, we saw organic growth around 6% in the second quarter going to 3% in the third, and then reaccelerating a little bit in September, October. Chris, I think you described the September pickup as noticeable. I'm just trying to get a sense given the triangulation of the full year guidance delivering 5%, 6% total. If we should be thinking about getting back to that 5%, 6% growth rate in the fourth quarter. And really what I'm getting at is, how much of a pickup really did you see? And if you could even go month by month, just to give us a sense of the magnitude of that pickup and how we should be thinking about 4Q?

Chris Klein

Kind of across the businesses, it's it was significant. It was noticeable in each part of the business as we transition out of August into September and the channels are still pretty lean, so POS was moving, order rates were flowing and that will continue into October. So we feel quite comfortable as we sit here right now and looking out to the full year guidance. Pat, maybe you have a little bit more detail in terms of how it plays out?

Pat Hallinan

Yes. I mean by the fourth quarter, Mike, we will have fully anniversary-ed Fiberon. Fiberon is in the organic sales number for the fourth quarter. And we would expect in the fourth quarter to be seeing reported sales at or above 4% and organic sales at or above 4%. The decking business is really performing strongly as we got through the wet spring and early summer. And not only we see just native demand, but the distribution gain and some of the loads that come with those distribution gain. It would be continued strong performance in Plumbing. Both U.S. POS has been mid-single digits. It finished the quarter stronger than mid-single digits. And we would expect China to stay double digits. And then cabinets will be flat or down slightly. Remember, they're comping against the 53rd week they had in the fourth quarter last year. But we would expect fourth quarter organic sales to be around 4-plus percent, to deliver a year in the range we gave you, the 5% to 6% range.

Michael Rehaut

Appreciate that. Secondly, the bigger picture question, and again I think there was a question earlier about this, but the cabinets leadership change, appreciating succession plans and Dave's desire to retire. But at the same time, it's interesting questions we've received around a prior -- bringing in someone who's a CEO of a public company to lead the division. From that, I guess, really two things that I think most people are trying to understand around this.

Number one, Nick, as you look at Dave coming in, what are the things that you really are hoping to get out of the segment over the next year or 2, both from a top line and margin perspective, given this may still be considered somewhat of a transition year although you're still getting momentum on the value side?

And two, maybe you could address some of the investor questions around potentiality of this as a spin or whether or not over the longer term, it's something you see potentially as not being part of the overall portfolio. Obviously, there's been changes around the cabinets industry and ownership of some of the bigger participants still forthcoming. And so should we be thinking about this leadership transition is a signal that you're kind of -- as part of your overall portfolio, how you're thinking about whether or not this is a permanent fixture.

Nick Fink

Sure. Sure, I'd be happy to address that. I'll start by saying and reiterating the we're really excited to have Dave Banyard come on board. You've got an executive here who's got a blue chip Danaher and Roper manufacturing experience, a proven track record at doubling free cash flow at Myers, and so somebody that we think we've been incredibly fortunate to attract to this business. I think it also speaks to the opportunity in the Cabinets business. You don't attract talent like that to a business that doesn't have real opportunity ahead. And so I'd start with that as the baseline.

What would we expect? What we would expect to see Dave Banyard bring us some external view, not from the cabinet industry. So he's going to bring us some external view on some best-in-class manufacturing and commercial leadership from his experience. So we're going to marry that with the deep cabinet experience that the rest of our team has. And from that, we expect to see elevated pivot and results with that as we push towards higher margins coming out the business. And we expect to see us really taking advantage of what we believe are significant growth opportunities in the marketplace coming from that value segment to which we believe we are incredibly well positioned now having built out the capacity which we will continue to build and having these new product launches come into the market that you're already seeing be really, really well received. And so we think it's actually an incredible time to have a new leader come in, perhaps give us a bit more fresh perspective and then drive the kind of performance that we've seen Dave Banyard drive in the other businesses that he's led across his career. So all that is a great backdrop.

Now what I'll say and besides the rest of the question is, we have a great set of businesses and we work them very, very hard. And against that, we're seeing some increasing success. And if the market improves, we're going to see more success. And with that being in the back half of this pivot plan, we expect to see results both on the cost piece and on some of the growth initiatives and we're really excited about those opportunities ahead. It is deeply embedded within our DNA at Fortune Brands to drive shareholder value. And we have always and we will always continue to assess all avenues to create value when the right opportunities arise. And so we will see ourselves rewarded for driving value and improving this business, and we will find a path to do so.

Operator

That is all the time we have for questions. Thank you very much for joining today's conference call and you may now disconnect.