Fortune Brands Home & Security, Inc.
Form 10-Q
November 01, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2013

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-35166

FORTUNE BRANDS HOME & SECURITY, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**62-1411546**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

520 Lake Cook Road, Deerfield, Illinois 60015-5611

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (847) 484-4400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, at October 25, 2013 was 166,215,043.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Nine and Three Months Ended September 30, 2013 and 2012

(In millions, except per share amounts)

(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2013	2012	2013	2012
Net sales	$ 3,055.5	$ 2,643.2	$ 1,125.1	$ 909.1
Cost of products sold	1,993.4	1,776.7	740.2	606.8
Selling, general and administrative expenses	767.4	699.6	259.6	236.2
Amortization of intangible assets	9.1	8.6	4.0	2.4
Restructuring charges	2.7	4.1	1.5	3.1
Asset impairment charge	21.2		21.2	
Operating income	261.7	154.2	98.6	60.6
Interest expense	5.5	6.6	2.1	2.0
Other expense (income), net	5.4	(0.6)	(0.5)	(0.8)
Income before income taxes	250.8	148.2	97.0	59.4
Income tax provision	84.5	47.1	32.4	19.2
Net income	166.3	101.1	64.6	40.2
Less: Noncontrolling interests	0.8	0.8	0.4	0.2
Net income attributable to Home & Security	$ 165.5	$ 100.3	$ 64.2	$ 40.0
Basic earnings per common share	$ 1.00	$ 0.63	$ 0.39	$ 0.25
Diluted earnings per common share	$ 0.97	$ 0.61	$ 0.37	$ 0.24
Dividends declared per common share	$ 0.30	$	$ 0.20	$
Comprehensive income	$ 187.5	$ 114.8	$ 64.3	$ 54.0

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

(Unaudited)

	September 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$ 157.0	$ 336.0
Accounts receivable, net	517.7	381.7
Inventories	463.1	357.2
Other current assets	135.8	153.0
Total current assets	1,273.6	1,227.9
Property, plant and equipment, net	513.5	509.4
Goodwill	1,521.1	1,381.4
Other intangible assets, net of accumulated amortization	760.7	683.6
Other assets	50.4	71.6
Total assets	$ 4,119.3	$ 3,873.9
Liabilities and equity		
Current liabilities		
Notes payable to banks	$ 5.6	$ 5.5
Current portion of long-term debt		22.5
Accounts payable	344.4	287.0
Other current liabilities	357.9	317.4
Total current liabilities	707.9	632.4
Long-term debt	350.0	297.5
Deferred income taxes	227.9	224.0
Accrued defined benefit plans	193.7	252.7
Other non-current liabilities	85.8	82.6
Total liabilities	1,565.3	1,489.2
Equity		
Home & Security stockholders equity		
Common stock[(a)]	1.7	1.6
Paid-in capital	2,406.3	2,324.8
Accumulated other comprehensive income	51.6	30.6
Retained earnings	156.7	41.0
Treasury stock	(65.8)	(16.9)

Total Home & Security stockholders equity		2,550.5		2,381.1
Noncontrolling interests		3.5		3.6
Total equity		2,554.0		2,384.7
Total liabilities and equity	$	4,119.3	$	3,873.9

(a) *Common stock, par value $0.01 per share; 166.0 million shares and 164.6 million shares issued at September 30, 2013 and December 31, 2012, respectively.*

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30, 2013 and 2012

(In millions)

(Unaudited)

	2013	2012
Operating activities		
Net income	$ 166.3	$ 101.1
Non-cash pre-tax expense:		
Depreciation	57.1	70.4
Amortization	9.1	8.6
Stock-based compensation	19.8	20.4
Recognition of actuarial losses	5.6	3.7
Asset impairment charges	27.4	
Loss (gain) on sale of property, plant and equipment	0.8	(3.0)
Deferred income taxes	(0.9)	5.6
Changes in assets and liabilities:		
Increase in accounts receivable	(97.4)	(58.8)
Increase in inventories	(79.9)	(53.6)
Increase (decrease) in accounts payable	40.8	(8.1)
Decrease in other assets	26.2	14.2
(Decrease) increase in accrued expenses and other liabilities	(19.9)	15.9
Increase in accrued taxes	11.2	3.0
Net cash provided by operating activities	166.2	119.4
Investing activities		
Capital expenditures	(55.2)	(46.0)
Proceeds from the disposition of assets	2.1	12.6
Cost of acquisition, net of cash	(302.0)	
Other investing activities	(0.2)	(5.0)
Net cash used in investing activities	(355.3)	(38.4)
Financing activities		
Increase in short-term debt, net	0.9	1.5
Issuance of long-term debt	220.0	70.0
Repayment of long-term debt	(190.0)	(137.5)
Proceeds from the exercise of stock options	41.3	80.6
Payment to Beam Inc.		(6.0)
Treasury stock purchases	(43.1)	(2.2)
Tax benefit on exercise of stock options	16.5	5.9
Dividends to stockholders	(33.2)	

Other financing	(2.6)	(1.1)
Net cash provided by financing activities	9.8	11.2
Effect of foreign exchange rate changes on cash	0.3	3.1
Net (decrease) increase in cash and cash equivalents	$ (179.0)	$ 95.3
Cash and cash equivalents at beginning of period	$ 336.0	$ 120.8
Cash and cash equivalents at end of period	$ 157.0	$ 216.1

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

For the Nine Months Ended September 30, 2013 and 2012

(In millions)

(Unaudited)

	Common Stock	Paid-In Capital	Accumulated Other Comprehensive Income	Retained (Deficit) Earnings	Treasury Stock	Non-controlling Interests	Total Equity
Balance at December 31, 2011	$ 1.6	$ 2,186.4	$ 10.6	$ (77.7)	$ (0.1)	$ 3.7	$ 2,124.5
Comprehensive income:							
Net income				100.3		0.8	101.1
Other comprehensive income			13.7				13.7
Stock options exercised		80.6					80.6
Stock-based compensation		20.6			(4.9)		15.7
Tax benefit on exercise of stock options		7.1					7.1
Separation-related adjustments		(5.1)					(5.1)
Treasury stock purchases					(2.2)		(2.2)
Dividends paid to noncontrolling interests						(1.1)	(1.1)
Balance at September 30, 2012	$ 1.6	$ 2,289.6	$ 24.3	$ 22.6	$ (7.2)	$ 3.4	$ 2,334.3
Balance at December 31, 2012	$ 1.6	$ 2,324.8	$ 30.6	$ 41.0	$ (16.9)	$ 3.6	$ 2,384.7
Comprehensive income:							
Net income				165.5		0.8	166.3
Other comprehensive income			21.0			0.2	21.2
Stock options exercised	0.1	41.3					41.4
Stock-based compensation		20.1			(6.2)		13.9
Tax benefit on exercise of stock options [(a)]		20.1					20.1
Treasury stock purchase					(42.7)		(42.7)
Dividends ($0.30 per Common share)				(49.8)			(49.8)
Dividends paid to noncontrolling interests						(1.1)	(1.1)
Balance at September 30, 2013	$ 1.7	$ 2,406.3	$ 51.6	$ 156.7	$ (65.8)	$ 3.5	$ 2,554.0

[(a)] *Includes $4.1 million of adjustments related to prior years vested and unvested Restricted Stock Units.*

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

References to Home & Security, the Company, we, our and us refer to Fortune Brands Home & Security, Inc. a consolidated subsidiaries as a whole, unless the context otherwise requires.

The Company is a leading home and security products company with a portfolio of leading branded products used for residential home repair, remodeling, new construction, security applications and storage.

The condensed consolidated balance sheet as of September 30, 2013, the related condensed consolidated statements of comprehensive income for the nine-month and three-month periods ended September 30, 2013 and 2012 and the related condensed consolidated statements of cash flows and equity for the nine-month periods ended September 30, 2013 and 2012 are unaudited. In the opinion of management, all adjustments necessary for a fair statement of the financial statements have been included. Interim results may not be indicative of results for a full year.

The condensed consolidated financial statements and notes are presented pursuant to the rules and regulations of the Securities and Exchange Commission and do not contain certain information included in our audited consolidated financial statements and notes. The year-end condensed consolidated balance sheet was derived from the audited consolidated financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles (GAAP). This Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2012.

2. Recently Issued Accounting Standards

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. ASU 2013-11 provides explicit guidance on presentation in financial statements. The amendment is effective for reporting periods beginning after December 15, 2013 (calendar year 2014 for Home & Security). We believe that adoption of this standard will not have a material impact on our financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards (Continued)

Parent s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity

In March 2013, the FASB issued ASU 2013-05, Parent s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. ASU 2013-05 clarifies the accounting for the release of the cumulative translation adjustment into net income when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. The ASU also clarifies the treatment of business combinations achieved in stages involving a foreign entity. The amendment is effective prospectively for reporting periods beginning after December 15, 2013 (calendar year 2014 for Home & Security). We believe that adoption of this standard will not have a material impact on our financial statements.

3. Balance Sheet Information

Supplemental information on our balance sheets is as follows:

(In millions)	September 30, 2013	December 31, 2012
Inventories:		
Raw materials and supplies	$ 186.3	$ 144.3
Work in process	47.6	38.6
Finished products	229.2	174.3
Total inventories	$ 463.1	$ 357.2
Property, plant and equipment, gross	$ 1,528.7	$ 1,491.2
Less: accumulated depreciation	1,015.2	981.8
Property, plant and equipment, net	$ 513.5	$ 509.4

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Acquisitions

In June 2013, our Kitchen & Bath Cabinetry business acquired Woodcrafters Home Products Holding, LLC (WoodCrafters), a manufacturer of bathroom vanities and tops for a purchase price of approximately $302 million, subject to certain post-closing adjustments. We paid the purchase price using a combination of cash on hand and borrowings under our existing credit facilities. This acquisition greatly expands our offerings of bathroom cabinetry products. Net sales and operating income of WoodCrafters in the third quarter of 2013 were approximately $60 million and $5 million, respectively.

The following table summarizes the preliminary allocation of the purchase price to estimated fair values of assets acquired and liabilities assumed as of the date of the acquisition. This allocation is expected to change after asset and liability valuations are finalized.

(In millions)	
Accounts receivable	$ 41.4
Inventories	26.3
Property, plant and equipment	29.5
Goodwill	141.5
Identifiable intangible assets	89.4
Other assets	8.9
Total assets	337.0
Other current liabilities and accruals	35.0
Net assets acquired	$ 302.0

As of the acquisition date, all of the acquired goodwill was tax deductible. Identifiable intangible assets primarily consisted of customer relationships ($75.9 million) and technology ($9.6 million). The useful lives of these identifiable intangible assets were 18 years and 10 years, respectively.

The following unaudited pro forma summary presents consolidated financial information as if WoodCrafters had been acquired on January 1, 2012. The unaudited pro forma financial information is based on historical results of operations and financial position of the Company and WoodCrafters. The pro forma results include adjustments for the impact of a preliminary allocation of the purchase price and interest expense associated with debt that would have been incurred in connection with the acquisition. The unaudited pro forma financial information does not necessarily represent the results that would have occurred had the acquisition occurred on January 1, 2012. In addition, the unaudited pro forma information should not be deemed to be indicative of future results.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Acquisitions (Continued)

(In millions)	Nine Months Ended September 30, 2013	Nine Months Ended September 30, 2012	Three Months Ended September 30, 2013	Three Months Ended September 30, 2012
Net sales	$ 3,162.9	$ 2,773.6	$ 1,125.1	$ 956.2
Net income attributable to Home & Security	175.1	105.2	64.2	44.7
Basic earnings per common share	$ 1.06	$ 0.66	$ 0.39	$ 0.28
Diluted earnings per common share	$ 1.02	$ 0.64	$ 0.37	$ 0.27

In December 2012, our Security & Storage business acquired a company for approximately $20 million in cash. Purchase price adjustments and the allocation of the purchase price were finalized in the first quarter of 2013. Our December 31, 2012 balance sheet was retrospectively adjusted to reflect the purchase price adjustments in accordance with Accounting Standards Codification (ASC) requirements for Business Combinations, in particular a reduction in goodwill of $5.6 million and an increase in definite-lived intangible assets of $5.9 million. The acquisition was not material for the purposes of supplemental disclosure and does not have a material impact on our consolidated financial statements.

5. Goodwill and Other Identifiable Intangible Assets

The change in the net carrying amount of goodwill by segment was as follows:

(In millions)	Kitchen & Bath Cabinetry	Plumbing & Accessories	Advanced Material Windows & Door Systems	Security & Storage	Total Goodwill
Goodwill at December 31, 2012 [(a)]	$ 491.8	$ 569.7	$ 229.1	$ 90.8	$ 1,381.4
WoodCrafters acquisition	141.5				141.5
Year-to-date translation adjustments	(1.2)			(0.6)	(1.8)
Goodwill at September 30, 2013 [(a)]	$ 632.1	$ 569.7	$ 229.1	$ 90.2	$ 1,521.1

(a) Net of accumulated impairment losses of $541.4 million ($451.3 million in the Advanced Material Windows & Door Systems segment and $90.1 million in the Security & Storage segment).

Amortizable identifiable intangible assets, principally tradenames and customer relationships, are subject to amortization over their estimated useful life, 5 to 30 years, based on the assessment of a number of factors that may impact useful life. These factors include historical and tradename performance with respect to consumer name recognition, geographic market presence, market share, plans for ongoing tradename support and promotion and other relevant factors. The gross carrying value increase of $88.7 million was principally due to the identifiable intangible assets associated with the acquisition of WoodCrafters.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Goodwill and Other Identifiable Intangible Assets (Continued)

The gross carrying value and accumulated amortization by class of intangible assets as of September 30, 2013 and December 31, 2012 were as follows:

	As of September 30, 2013			As of December 31, 2012		
(In millions)	Gross Carrying Amounts	Accumulated Amortization	Net Book Value	Gross Carrying Amounts	Accumulated Amortization	Net Book Value
Indefinite-lived tradenames	$ 600.4	$ (42.0)[a]	$ 558.4	$ 603.4	$ (42.0)[a]	$ 561.4
Amortizable intangible assets						
Tradenames	20.0	(7.4)	12.6	17.8	(6.9)	10.9
Customer and contractual relationships	350.1	(180.6)	169.5	274.2	(174.4)	99.8
Patents/proprietary technology	63.2	(43.0)	20.2	52.6	(41.1)	11.5
Total	433.3	(231.0)	202.3	344.6	(222.4)	122.2
Total identifiable intangibles	$ 1,033.7	$ (273.0)	$ 760.7	$ 948.0	$ (264.4)	$ 683.6

[a] *Accumulated amortization prior to the adoption of revised ASC requirements for Intangibles Goodwill and Other Assets.*

6. Asset Impairment Charges

At the end of the third quarter, our Kitchen and Bath Cabinetry segment completed an evaluation of its information technology strategy. The evaluation considered opportunities arising from the improving U.S. home market conditions. As a result of this evaluation, the segment abandoned certain software developed for internal use in order to redirect financial resources toward developing more flexible systems that provide industry leading content for consumers and more advanced tools for designers to deliver a superior purchasing experience for our customers. The abandonment of this internal use software resulted in a pre-tax impairment charge of $21.2 million, which was recorded in operating income and reduced property, plant and equipment.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Asset Impairment Charges (Continued)

In the first nine months of 2013, no events or circumstances occurred that would have required us to perform interim impairment tests of goodwill or indefinite-lived intangible assets. Any future reduction in the estimated fair value of the indefinite-lived tradenames that were impaired in the fourth quarter of 2012 would result in an impairment charge. The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and other intangible assets. Such events may include, but are not limited to, the impact of the economic environment, a material negative change in relationships with significant customers, and strategic decisions made in response to economic and competitive conditions. While our cash flow projections used to assess impairment of our goodwill and other intangible assets are influenced by a number of variables, they are most significantly influenced by our projection for the recovery of the U.S. home products markets in the next 3 to 5 years. We evaluate our projection of the U.S. home products market periodically and in connection with our annual operating plans finalized in the fourth quarter of each year. The U.S. home products market is highly dependent on U.S. new home construction. Our projection for the U.S. home products markets is inherently subject to a number of uncertain factors, such as employment, home prices, credit availability, and the rate of home foreclosures. Significant changes in these and other factors could cause us to change our cash flow projections in future periods which could trigger impairment of goodwill or indefinite-lived intangible assets in the period in which such changes occur.

7. External Debt and Financing Arrangements

We have a $650 million committed revolving credit facility, as well as a $350 million term loan. In July 2013, these facilities were renewed under essentially the same terms and conditions, extending the maturity date from October 2016 to July 2018. The outstanding borrowings under the term loan were $350.0 million and $320.0 million as of September 30, 2013 and December 31, 2012, respectively. In connection with the modification of the term loan, we recorded a $0.3 million write-off of unamortized deferred loan costs in interest expense. There were no outstanding balances under the revolving credit facility as of September 30, 2013 and December 31, 2012. The interest rates under these facilities are variable based on LIBOR at the time of the borrowing and the Company s leverage as measured by a debt to Adjusted EBITDA ratio (as defined in the agreements governing the facilities). Based upon the Company s debt to Adjusted EBITDA ratio, the Company s borrowing rate could range from LIBOR + 1.0% to LIBOR + 2.0%. As of September 30, 2013, we were in compliance with all covenants under these facilities.

At September 30, 2013 and December 31, 2012, there were $5.6 million and $5.5 million of external short-term borrowings outstanding, respectively, comprised of notes payable to banks that are used for general corporate purposes. These amounts pertained to uncommitted bank lines of credit in China and India, which provide for unsecured borrowings for working capital of up to $22.7 million in aggregate, as of both September 30, 2013 and December 31, 2012. The weighted-average interest rates on these borrowings were 12.4% and 12.3% in the nine-month periods ended September 30, 2013 and 2012, respectively. The weighted-average interest rates on these borrowings were 12.5% in the three-month periods ended September 30, 2013 and 2012.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Financial Instruments

We do not enter into derivative instruments for trading or speculative purposes. We principally use financial instruments to reduce the impact of changes in foreign currency exchange rates and commodities used as raw materials in our products. The principal derivative financial instruments we enter into on a routine basis are foreign exchange contracts.

Our primary foreign currency hedge contracts pertain to the Canadian dollar, the Chinese yuan, the Mexican peso and the Euro. The gross U.S. dollar equivalent notional amount of all of our foreign currency derivative hedges outstanding at September 30, 2013 was $167.1 million, representing a net receivable of $1.7 million. Based on foreign exchange rates as of September 30, 2013, we estimate that $1.3 million of pre-tax foreign currency derivative net gains included in other comprehensive income as of September 30, 2013 will be reclassified to earnings within the next twelve months.

The fair values of derivative instruments on the consolidated balance sheets as of September 30, 2013 and December 31, 2012 were:

		Fair Value	
(In millions)		September 30, 2013	December 31, 2012
Assets			
Foreign exchange contracts	Other current assets	$ 1.9	$ 1.0
Commodity contracts	Other current assets		0.2
	Total assets	$ 1.9	$ 1.2
Liabilities			
Foreign exchange contracts	Other current liabilities	$ 0.2	$ 0.8
Commodity contracts	Other current liabilities	0.1	0.1
Net investment hedges	Other current liabilities	0.4	
	Total liabilities	$ 0.7	$ 0.9

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Financial Instruments (Continued)

The effects of derivative financial instruments on the statements of comprehensive income for the nine and three months ended September 30, 2013 and 2012 were:

(In millions)	Gain (Loss) Recognized in Income in Nine Months Ended September 30,		
Type of hedge	Location	2013	2012
Cash flow	Net sales	$	$ 0.1
	Cost of products sold	2.3	0.5
Fair value	Other income (expense), net	1.3	(0.5)
Total		$ 3.6	$ 0.1

(In millions)	Gain (Loss) Recognized in Income in Three Months Ended September 30,		
Type of hedge	Location	2013	2012
Cash flow	Cost of products sold	$ 0.9	$ 0.2
Fair value	Other income (expense), net	1.3	(1.1)
Total		$ 2.2	$ (0.9)

In the nine months ended September 30, 2013 and 2012, for cash flow hedges that are effective, the amounts recognized in other comprehensive income were $3.3 million and $(1.3) million, respectively. In the three months ended September 30, 2013 and 2012, for cash flow hedges that are effective, the amounts recognized in other comprehensive income were $1.0 million and $(1.4) million, respectively. In the nine and three months ended September 30, 2013 and 2012, the ineffective portion of cash flow hedges recognized in other expense (income), net, was insignificant.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Fair Value Measurements

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2013 and December 31, 2012 were as follows:

	Fair Value	
(In millions)	September 30, 2013	December 31, 2012
Assets		
Derivative financial instruments (level 2)	$ 1.9	$ 1.2
Deferred compensation program assets (level 1)	3.3	3.6
Total assets	$ 5.2	$ 4.8
Liabilities		
Derivative financial instruments (level 2)	$ 0.7	$ 0.9

The principal derivative financial instruments we enter into on a routine basis are foreign exchange contracts. Derivative financial instruments are recorded at fair value.

ASC requirements for Fair Value Measurements and Disclosures establish a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs, the highest priority, are quoted prices in active markets for identical assets or liabilities. Level 2 inputs reflect inputs other than quoted prices included in Level 1 that are either observable directly or through corroboration with observable market data. Level 3 inputs are unobservable inputs, due to little or no market activity for the asset or liability, such as internally-developed valuation models. We do not have any assets or liabilities measured at fair value on a recurring basis that are Level 3.

The carrying value of the Company s long-term debt as of September 30, 2013 and December 31, 2012 of $350.0 million and $320.0 million, respectively, approximated its fair value. The fair value of the Company s long-term debt was determined primarily by using broker quotes, which are Level 2 inputs.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Defined Benefit Plans

The components of net periodic benefit cost for pension and postretirement benefits for the nine and three months ended September 30, 2013 and 2012 were as follows:

	Nine Months Ended September 30,			
	Pension Benefits		Postretirement Benefits	
(In millions)	2013	2012	2013	2012
Service cost	$ 8.6	$ 9.1	$ 0.3	$ 0.3
Interest cost	22.5	23.0	1.3	3.1
Expected return on plan assets	(31.3)	(27.7)		
Amortization of prior service costs (credits)	0.1	0.3	(21.5)	0.3
Recognition of actuarial losses	0.8	1.9	4.8	1.8
Curtailment and settlement losses	0.1		0.1	
Net periodic benefit cost	$ 0.8	$ 6.6	$ (15.0)	$ 5.5

	Three Months Ended September 30,			
	Pension Benefits		Postretirement Benefits	
(In millions)	2013	2012	2013	2012
Service cost	$ 2.3	$ 1.6	$ 0.1	$ 0.1
Interest cost	7.5	7.7	0.3	1.0
Expected return on plan assets	(10.5)	(9.2)		
Amortization of prior service costs (credits)		0.1	(5.7)	0.1
Recognition of actuarial losses (gains)	0.7	1.9	(0.5)	1.8
Curtailment and settlement losses	0.1		0.1	
Net periodic benefit cost	$ 0.1	$ 2.1	$ (5.7)	$ 3.0

In the fourth quarter of 2012 and first half of 2013, we amended certain postretirement benefit plans to reduce health benefits for certain current and retired employees. The impact of these changes was a reduction in accrued retiree benefit plans of $29.8 million in the fourth quarter of 2012 and $34.8 million in the first nine months of 2013, and we recognized actuarial losses of $4.8 million in the first nine months of 2013 due to a decrease in the discount rate and a resulting lower threshold for loss recognition because of the reduced postretirement obligation. Liability reductions from these plan amendments are recorded as amortization of prior service credits in net income in accordance with accounting requirements. In addition, in the first quarter of 2013, we communicated to certain employees our decision to freeze an hourly pension plan by December 31, 2016. As a result, we remeasured our pension liability, updating our pension measurement assumptions, and recorded a $20.0 million reduction in the liability. The curtailment charge associated with this pension freeze was insignificant. See Note 17, Accumulated Other Comprehensive Income, for information on the impact on accumulated other comprehensive income. Due to higher interest rates and higher than expected returns on pension plan assets through September 30, 2013, we do not expect to make pension contributions in 2013.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Income Taxes

The effective income tax rates for the nine months ended September 30, 2013 and 2012 were 33.7% and 31.8%, respectively. The effective income tax rate in 2013 was unfavorably impacted by an investment impairment charge for which we could not record an income tax benefit and favorably impacted by the tax benefits associated with the extension of the research and development credit under The American Taxpayer Relief Act of 2012, including the full-year credit attributable to 2012. The effective income tax rate in 2012 was favorably impacted by a discrete foreign income tax benefit and a decrease in the valuation allowance related to certain restructuring actions.

The effective income tax rates for the three months ended September 30, 2013 and 2012 were 33.4% and 32.3%, respectively. The effective income tax rate in 2012 was favorably impacted by a decrease in the valuation allowance related to certain restructuring actions.

It is reasonably possible that, within the next 12 months, total unrecognized tax benefits may decrease in the range of $2.5 million to $3.5 million, primarily as a result of the conclusion of pending U.S. federal, state and foreign income tax proceedings.

On September 13, 2013, the Treasury Department and Internal Revenue Service issued the final tangible property repair regulations that are effective for years beginning on or after January 1, 2014. While we are still analyzing the final impact of these regulations on our 2013 financial statements, we do not expect the impact to be significant.

12. Product Warranties

We generally record warranty expense at the time of sale. We offer our customers various warranty terms based on the type of product that is sold. Warranty expense is determined based on historic claim experience and the nature of the product category. The following table summarizes activity related to our product warranty liability for the nine months ended September 30, 2013 and 2012, respectively.

	Nine Months Ended September 30,	
(In millions)	2013	2012
Reserve balance at January 1,	$ 14.3	$ 13.9
Provision for warranties issued	14.9	12.7
Settlements made (in cash or in kind)	(14.4)	(12.7)
Reserve balance at September 30,	$ 14.8	$ 13.9

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Information on Business Segments

Net sales and operating income for the nine months ended September 30, 2013 and 2012 by segment were as follows:

	Nine Months Ended September 30,		
(In millions)	2013	2012	% Change vs. Prior Year
Net Sales			
Kitchen & Bath Cabinetry	$ 1,186.3	$ 987.1	20.2%
Plumbing & Accessories	969.6	804.2	20.6
Advanced Material Windows & Door Systems	481.7	431.4	11.7
Security & Storage	417.9	420.5	(0.6)
Net sales	$ 3,055.5	$ 2,643.2	15.6%
Operating Income			
Kitchen & Bath Cabinetry	$ 63.8	$ 14.1	%
Plumbing & Accessories	176.2	127.5	38.2