

Fortune Brands Home & Security, Inc.  
Form 10-Q  
May 01, 2014

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**Form 10-Q**

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

**For the quarterly period ended March 31, 2014**

**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**  
**(State or other jurisdiction of  
incorporation or organization)**

**62-1411546**  
**(I.R.S. Employer  
Identification No.)**

**520 Lake Cook Road, Deerfield, Illinois**  
**(Address of principal executive offices)**

**60015-5611**  
**(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  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). 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

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

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, at April 25, 2014 was 166,051,975.

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**PART I. FINANCIAL INFORMATION**
**Item 1. FINANCIAL STATEMENTS.****FORTUNE BRANDS HOME & SECURITY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Three Months Ended March 31, 2014 and 2013**

(In millions, except per share amounts)

(Unaudited)

|  | 2014     | 2013     |
|--|----------|----------|
| Net sales                                    | \$ 966.2 | \$ 890.0 |
| Cost of products sold                        | 651.5    | 589.8    |
| Selling, general and administrative expenses | 246.3    | 240.1    |
| Amortization of intangible assets            | 4.0      | 2.6      |
| Restructuring charges                        | 2.3      | 0.9      |
| Operating income                             | 62.1     | 56.6     |
| Interest expense                             | 1.9      | 1.7      |
| Other income, net                            | (0.5)    | (0.2)    |
| Income before income taxes                   | 60.7     | 55.1     |
| Income tax provision                         | 19.5     | 17.6     |
| Net income                                   | 41.2     | 37.5     |
| Less: Noncontrolling interests               | 0.4      | 0.2      |
| Net income attributable to Home & Security   | \$ 40.8  | \$ 37.3  |
| Basic earnings per common share              | \$ 0.25  | \$ 0.23  |
| Diluted earnings per common share            | \$ 0.24  | \$ 0.22  |
| Comprehensive income                         | \$ 33.4  | \$ 64.6  |

See notes to condensed consolidated financial statements.

**FORTUNE BRANDS HOME & SECURITY, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(In millions)

(Unaudited)

|  | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
| <b>Assets</b>  |                   |                      |
| <b>Current assets</b>  |                   |                      |
| Cash and cash equivalents                                      | \$ 124.2          | \$ 241.4             |
| Accounts receivable, net                                       | 482.9             | 477.1                |
| Inventories  | 509.5             | 471.6                |
| Other current assets   | 148.1             | 137.3                |
| <b>Total current assets</b>                                    | <b>1,264.7</b>    | <b>1,327.4</b>       |
| Property, plant and equipment, net of accumulated depreciation | 532.1             | 534.4                |
| Goodwill   | 1,518.0           | 1,519.9              |
| Other intangible assets, net of accumulated amortization       | 744.9             | 752.9                |
| Other assets   | 47.1              | 43.5                 |
| <b>Total assets</b>  | <b>\$ 4,106.8</b> | <b>\$ 4,178.1</b>    |
| <b>Liabilities and equity</b>                                  |                   |                      |
| <b>Current liabilities</b>                                     |                   |                      |
| Notes payable to banks   | \$ 9.7            | \$ 6.0               |
| Accounts payable   | 319.8             | 343.8                |
| Other current liabilities                                      | 237.4             | 388.9                |
| <b>Total current liabilities</b>                               | <b>566.9</b>      | <b>738.7</b>         |
| Long-term debt   | 475.0             | 350.0                |
| Deferred income taxes  | 247.7             | 245.8                |
| Other non-current liabilities                                  | 177.2             | 190.5                |
| <b>Total liabilities</b>                                       | <b>1,466.8</b>    | <b>1,525.0</b>       |
| <b>Commitments and contingencies (see Note 16)</b>             |                   |                      |
| <b>Equity</b>  |                   |                      |
| <b>Home &amp; Security stockholders' equity</b>                |                   |                      |
| Common stock <sup>(a)</sup>                                    | 1.7               | 1.7                  |
| Paid-in capital  | 2,462.4           | 2,431.3              |
| Accumulated other comprehensive income                         | 87.8              | 95.4                 |
| Retained earnings  | 241.8             | 200.8                |
| Treasury stock   | (156.5)           | (79.8)               |
| <b>Total Home &amp; Security stockholders' equity</b>          | <b>2,637.2</b>    | <b>2,649.4</b>       |

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|                              |            |            |
|------------------------------|------------|------------|
| Noncontrolling interests     | 2.8        | 3.7        |
| Total equity                 | 2,640.0    | 2,653.1    |
| Total liabilities and equity | \$ 4,106.8 | \$ 4,178.1 |

<sup>(a)</sup> *Common stock, par value \$0.01 per share; 170.2 million shares and 169.1 million shares issued at March 31, 2014 and December 31, 2013, respectively.*

See notes to condensed consolidated financial statements.

**FORTUNE BRANDS HOME & SECURITY, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Three Months Ended March 31, 2014 and 2013**

(In millions)

(Unaudited)

|  | 2014    | 2013    |
|--|---------|---------|
| Operating activities   |         |         |
| Net income   | \$ 41.2 | \$ 37.5 |
| Non-cash pre-tax expense (income):                               |         |         |
| Depreciation   | 19.5    | 19.4    |
| Amortization   | 4.0     | 2.6     |
| Stock-based compensation   | 7.8     | 6.5     |
| Recognition of actuarial losses                                  | 0.6     | 4.6     |
| Deferred income taxes  | 11.7    | 7.0     |
| Restructuring charges  | 1.8     |         |
| Changes in assets and liabilities:                               |         |         |
| Increase in accounts receivable                                  | (7.7)   | (48.3)  |
| Increase in inventories  | (39.4)  | (23.0)  |
| (Decrease) increase in accounts payable                          | (22.5)  | 17.7    |
| (Increase) decrease in other assets                              | (24.4)  | 7.6     |
| Decrease in accrued expenses and other liabilities               | (149.9) | (103.6) |
| Increase (decrease) in accrued taxes                             | 0.7     | (0.5)   |
| Net cash used in operating activities                            | (156.6) | (72.5)  |
| Investing activities   |         |         |
| Capital expenditures   | (21.0)  | (14.4)  |
| Proceeds from the disposition of assets                          | 0.1     | 0.2     |
| Net cash used in investing activities                            | (20.9)  | (14.2)  |
| Financing activities   |         |         |
| Increase in short-term debt, net                                 | 3.5     | 0.8     |
| Issuance of long-term debt                                       | 185.0   |         |
| Repayment of long-term debt                                      | (60.0)  |         |
| Proceeds from the exercise of stock options                      | 8.2     | 16.9    |
| Treasury stock purchases   | (68.7)  | (13.5)  |
| Excess tax benefit from the exercise of stock-based compensation | 15.0    | 6.8     |
| Dividends to stockholders  | (19.9)  |         |
| Other financing, net   | (1.1)   | (1.1)   |
| Net cash provided by financing activities                        | 62.0    | 9.9     |

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|  |            |           |
|--|------------|-----------|
| Effect of foreign exchange rate changes on cash  | (1.7)      | (0.3)     |
| Net decrease in cash and cash equivalents        | \$ (117.2) | \$ (77.1) |
| Cash and cash equivalents at beginning of period | \$ 241.4   | \$ 336.0  |
| Cash and cash equivalents at end of period       | \$ 124.2   | \$ 258.9  |

See notes to condensed consolidated financial statements.

**FORTUNE BRANDS HOME & SECURITY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF EQUITY****For the Three Months Ended March 31, 2014 and 2013**

(In millions)

(Unaudited)

|   | Common<br>Stock | Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Treasury<br>Stock | Non-controlling<br>Interests | Total<br>Equity |
|---|-----------------|--------------------|---|----------------------|-------------------|------------------------------|-----------------|
| 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                                    |                 |                    |   | 37.3                 |                   | 0.2                          | 37.5            |
| Other comprehensive income                    |                 |                    | 27.1  |                      |                   |                              | 27.1            |
| Stock options exercised                       |                 | 16.9               |   |                      |                   |                              | 16.9            |
| Stock-based compensation                      |                 | 6.3                |   |                      | (3.9)             |                              | 2.4             |
| Tax benefit on exercise of<br>stock options   |                 | 6.8                |   |                      |                   |                              | 6.8             |
| Treasury stock purchase                       |                 |                    |   |                      | (13.1)            |                              | (13.1)          |
| Dividends paid to<br>noncontrolling interests |                 |                    |   |                      |                   | (1.1)                        | (1.1)           |
| Balance at March 31, 2013                     | \$ 1.6          | \$ 2,354.8         | \$ 57.7   | \$ 78.3              | \$ (33.9)         | \$ 2.7                       | \$ 2,461.2      |
| Balance at December 31, 2013                  | \$ 1.7          | \$ 2,431.3         | \$ 95.4   | \$ 200.8             | \$ (79.8)         | \$ 3.7                       | \$ 2,653.1      |
| Comprehensive income:                         |                 |                    |   |                      |                   |                              |                 |
| Net income                                    |                 |                    |   | 40.8                 |                   | 0.4                          | 41.2            |
| Other comprehensive income                    |                 |                    | (7.6)   |                      |                   | (0.2)                        | (7.8)           |
| Stock options exercised                       |                 | 8.2                |   |                      |                   |                              | 8.2             |
| Stock-based compensation                      |                 | 7.7                |   |                      | (8.0)             |                              | (0.3)           |
| Tax benefit on exercise of<br>stock options   |                 | 15.2               |   |                      |                   |                              | 15.2            |
| Treasury stock purchase                       |                 |                    |   |                      | (68.7)            |                              | (68.7)          |
| Other   |                 |                    |   | 0.2                  |                   |                              | 0.2             |
| Dividends paid to<br>noncontrolling interests |                 |                    |   |                      |                   | (1.1)                        | (1.1)           |
| Balance at March 31, 2014                     | \$ 1.7          | \$ 2,462.4         | \$ 87.8   | \$ 241.8             | \$ (156.5)        | \$ 2.8                       | \$ 2,640.0      |

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. and its 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 March 31, 2014, the related condensed consolidated statements of comprehensive income for the three-month periods ended March 31, 2014 and 2013 and the related condensed consolidated statements of cash flows and equity for the three-month periods ended March 31, 2014 and 2013 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 annual consolidated financial statements and notes. The year-end condensed consolidated balance sheet was derived from the audited 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, 2013.

**2. Recently Issued Accounting Standards**

*Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

In April 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This standard changes the definition of discontinued operations and requires expanded disclosures. The amendment is effective for annual periods beginning on or after December 15, 2014 (calendar 2015 for Home & Security). Early adoption is permitted. We do not expect this standard to have a material effect on our financial statements.

**FORTUNE BRANDS HOME & SECURITY, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Balance Sheet Information**

Supplemental information on our balance sheets is as follows:

| (In millions)                             | March 31,<br>2014 | December 31,<br>2013 |
|---|-------------------|----------------------|
| <b>Inventories:</b>                       |                   |                      |
| Raw materials and supplies                | \$ 200.5          | \$ 184.6             |
| Work in process                           | 55.6              | 52.5                 |
| Finished products                         | 253.4             | 234.5                |
| <b>Total inventories</b>                  | <b>\$ 509.5</b>   | <b>\$ 471.6</b>      |
| Property, plant and equipment, gross      | \$ 1,538.8        | \$ 1,556.1           |
| Less: accumulated depreciation            | 1,006.7           | 1,021.7              |
| <b>Property, plant and equipment, net</b> | <b>\$ 532.1</b>   | <b>\$ 534.4</b>      |

**4. Acquisition**

In June 2013, our Kitchen & Bath Cabinetry business acquired 100% of the voting equity of Woodcrafters Home Products Holding, LLC ( WoodCrafters ), a manufacturer of bathroom vanities and tops for a purchase price of approximately \$302 million. We paid the purchase price using a combination of cash on hand and borrowings under our existing credit facilities. This acquisition greatly expanded our offerings of bathroom cabinetry products. Net sales and operating income of WoodCrafters in the first quarter of 2014 were approximately \$50 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 may change after asset and liability valuations are finalized.

|                                |              |
|--------------------------------|--------------|
| (In millions)                  |              |
| Accounts receivable            | \$ 41.4      |
| Inventories                    | 25.7         |
| Property, plant and equipment  | 29.6         |
| Goodwill                       | 142.7        |
| Identifiable intangible assets | 89.4         |
| Other assets                   | 8.3          |
| <b>Total assets</b>            | <b>337.1</b> |
| Other liabilities and accruals | 35.1         |

|                     |          |
|---------------------|----------|
| Net assets acquired | \$ 302.0 |
|---------------------|----------|

Goodwill primarily represents expected supply chain synergies. Identifiable intangible assets primarily consisted of customer relationships (\$75.9 million) and technology (\$9.6 million). The useful lives of these identifiable intangible assets are 18 years and 10 years, respectively.

**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. Goodwill and Identifiable Intangible Assets**

We had goodwill of \$1,518.0 million as of March 31, 2014. The change in the net carrying amount of goodwill by segment was as follows:

| (In millions)                                | Kitchen &<br>Bath<br>Cabinetry | Plumbing &<br>Accessories | Advanced<br>Material<br>Windows &<br>Door Systems | Security &<br>Storage | Total<br>Goodwill |
|--|--------------------------------|---------------------------|---|-----------------------|-------------------|
| Goodwill at December 31, 2013 <sup>(a)</sup> | \$ 631.7                       | \$ 569.7                  | \$ 229.1  | \$ 89.4               | \$ 1,519.9        |
| Year-to-date translation adjustments         | (1.5)                          |                           |   | (0.8)                 | (2.3)             |
| Acquisition-related adjustments              | 0.4                            |                           |   |                       | 0.4               |
| Goodwill at March 31, 2014 <sup>(a)</sup>    | \$ 630.6                       | \$ 569.7                  | \$ 229.1  | \$ 88.6               | \$ 1,518.0        |

<sup>(a)</sup> 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 and accumulated amortization by class of intangible assets as of March 31, 2014 and December 31, 2013 were as follows:

| (In millions)                          | As of March 31, 2014         |                             |                      | As of December 31, 2013      |                             |                      |
|--|------------------------------|-----------------------------|----------------------|------------------------------|-----------------------------|----------------------|
|  | Gross<br>Carrying<br>Amounts | Accumulated<br>Amortization | Net<br>Book<br>Value | Gross<br>Carrying<br>Amounts | Accumulated<br>Amortization | Net<br>Book<br>Value |
| Indefinite-lived tradenames            | \$ 593.6                     | \$ (42.0) <sup>(a)</sup>    | \$ 551.6             | \$ 597.2                     | \$ (42.0) <sup>(a)</sup>    | \$ 555.2             |
| Amortizable intangible assets          |                              |                             |                      |                              |                             |                      |
| Tradenames                             | 19.3                         | (7.5)                       | 11.8                 | 19.6                         | (7.4)                       | 12.2                 |
| Customer and contractual relationships | 346.8                        | (184.2)                     | 162.6                | 348.6                        | (182.5)                     | 166.1                |
| Patents/proprietary technology         | 63.4                         | (44.5)                      | 18.9                 | 63.2                         | (43.8)                      | 19.4                 |
| Total                                  | 429.5                        | (236.2)                     | 193.3                | 431.4                        | (233.7)                     | 197.7                |
| Total identifiable intangibles         | \$ 1,023.1                   | \$ (278.2)                  | \$ 744.9             | \$ 1,028.6                   | \$ (275.7)                  | \$ 752.9             |

*(a) Accumulated amortization prior to the adoption of revised Accounting Standards Codification ( ASC ) requirements for Intangibles Goodwill and Other Assets.*

**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**5. Goodwill and Identifiable Intangible Assets (Continued)**

In the first quarter of 2014, no events or circumstances occurred that would have required us to perform interim impairment tests of goodwill or indefinite-lived intangible assets. As of December 31, 2013, the fair value of each of our reporting units except for one of the reporting units in the Advanced Material Doors & Windows segment exceeded the carrying value by a substantial margin. The estimated excess fair value of this reporting unit was less than 10%. In addition, for one of the tradenames within this reporting unit, fair value exceeded its carrying value by less than 10%. Accordingly, a reduction in the estimated fair value of this reporting unit or tradename could trigger an impairment. As of March 31, 2014, the book value of the goodwill of this reporting unit and this tradename was \$86.1 million and \$58.4 million, respectively.

The events and/or circumstances that could have a potential negative effect on the estimated fair value of our reporting units and indefinite-lived tradenames include: actual new construction and repair and remodel growth rates that lag our assumptions, actions of key customers, volatility of discount rates, continued economic uncertainty, higher levels of unemployment, weak consumer confidence, and lower levels of discretionary consumer spending. In addition, future decisions we could make with regard to acquisitions and divestitures could trigger a requirement to measure certain assets as held for sale with the resulting change in measurement standard potentially triggering impairments. While our cash flow projections used to assess impairment of our goodwill and other intangible assets held for use are influenced by a number of variables, they are most significantly influenced by our projection for the continued recovery of the U.S. home products markets in the next three years and our ability to execute on various planned cost reduction initiatives supporting operating income improvements forecasted to occur over the next three 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 and the rate of spending on repair and remodel activities. 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.

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**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**6. External Debt and Financing Arrangements**

We have a \$650 million committed revolving credit facility, as well as a \$350 million term loan, both of which expire in July 2018. On March 31, 2014 and December 31, 2013, our outstanding borrowings under these facilities were \$475.0 million and \$350.0 million, respectively. 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. Based upon the Company's debt to Adjusted EBITDA ratio at March 31, 2014, the Company's borrowing rate could range from LIBOR + 1.0% to LIBOR + 2.0%. As of March 31, 2014, we were in compliance with all covenants under these facilities.

At March 31, 2014 and December 31, 2013, there were \$9.7 million and \$6.0 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 March 31, 2014 and December 31, 2013. The weighted-average interest rates on these borrowings were 9.8% and 12.1% in the three-month periods ended March 31, 2014 and 2013, respectively.

**7. Financial Instruments**

We do not enter into financial 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. Derivative financial instruments are recorded at fair value. The counterparties to derivative contracts are major financial institutions. Management currently believes that the risk of incurring material losses is unlikely and that the losses, if any, would be immaterial to the Company. In addition, from time to time, we enter into commodity swaps.

Our primary foreign currency hedge contracts pertain to the Canadian dollar, the Chinese yuan and the Mexican peso. The gross U.S. dollar equivalent notional amount of all foreign currency derivative hedges outstanding at March 31, 2014 was \$201.9 million, representing a net settlement receivable of \$1.2 million. Based on foreign exchange rates as of March 31, 2014, we estimate that \$0.1 million of net foreign currency derivative gains included in other comprehensive income as of March 31, 2014 will be reclassified to earnings within the next twelve months.

**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**7. Financial Instruments (Continued)**

The fair values of derivative instruments on the consolidated balance sheets as of March 31, 2014 and December 31, 2013 were:

| (In millions)              | Location                  | Fair Value     |                   |
|----------------------------|---------------------------|----------------|-------------------|
|                            |                           | March 31, 2014 | December 31, 2013 |
| <b>Assets</b>              |                           |                |                   |
| Foreign exchange contracts | Other current assets      | \$ 1.9         | \$ 2.1            |
| Net investment hedges      | Other current assets      | 0.6            | 0.6               |
|                            | <b>Total assets</b>       | <b>\$ 2.5</b>  | <b>\$ 2.7</b>     |
| <b>Liabilities</b>         |                           |                |                   |
| Foreign exchange contracts | Other current liabilities | \$ 1.3         | \$ 0.3            |

The effects of derivative financial instruments on the statements of comprehensive income for the three months ended March 31, 2014 and 2013 were:

| (In millions) | Location              | Gain (Loss) Recognized in Income |                |
|---------------|-----------------------|----------------------------------|----------------|
|               |                       | March 31, 2014                   | March 31, 2013 |
| Cash flow     | Cost of products sold | \$ 0.7                           | \$ 0.4         |
| Fair value    | Other income, net     | 0.9                              | (0.2)          |
| <b>Total</b>  |                       | <b>\$ 1.6</b>                    | <b>\$ 0.2</b>  |

The effective portion of cash flow hedges recognized in other comprehensive income were net (losses) gains of \$(0.4) million and \$1.6 million at March 31, 2014 and 2013, respectively. In the three months ended March 31, 2014 and 2013, the ineffective portion of cash flow hedges recognized in other income, net, was insignificant.



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**FORTUNE BRANDS HOME & SECURITY, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****8. Fair Value Measurements**

Assets and liabilities measured at fair value on a recurring basis as of March 31, 2014 and December 31, 2013 were as follows:

| (In millions)                                  | Fair Value        |                      |
|--|-------------------|----------------------|
|  | March 31,<br>2014 | December 31,<br>2013 |
| <b>Assets</b>                                  |                   |                      |
| Derivative financial instruments (level 2)     | \$ 2.5            | \$ 2.7               |
| Deferred compensation program assets (level 1) | 3.1               | 3.5                  |
| Total assets                                   | \$ 5.6            | \$ 6.2               |
| <b>Liabilities</b>                             |                   |                      |
| Derivative financial instruments (level 2)     | \$ 1.3            | \$ 0.3               |

The principal derivative financial instruments we enter into on a routine basis are foreign exchange contracts. In addition, from time to time, we enter into commodity swaps. 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 March 31, 2014 and December 31, 2013 of \$475.0 million and \$350.0 million, respectively, approximated 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)****9. Defined Benefit Plans**

The components of net periodic benefit cost for pension and postretirement benefits for the three months ended March 31, 2014 and 2013 were as follows:

| (In millions)                        | Three Months Ended March 31, |        |                         |        |
|--------------------------------------|------------------------------|--------|-------------------------|--------|
|                                      | Pension Benefits             |        | Postretirement Benefits |        |
|                                      | 2014                         | 2013   | 2014                    | 2013   |
| Service cost                         | \$ 2.7                       | \$ 3.2 | \$                      | \$ 0.1 |
| Interest cost                        | 8.2                          | 7.5    | 0.2                     | 0.6    |
| Expected return on plan assets       | (10.6)                       | (10.3) |                         |        |
| Recognition of prior service credits |                              |        | (10.6)                  | (7.0)  |
| Recognition of actuarial losses      |                              |        | 0.6                     | 4.6    |

|                           |        |        |          |          |
|---------------------------|--------|--------|----------|----------|
| Net periodic benefit cost | \$ 0.3 | \$ 0.4 | \$ (9.8) | \$ (1.7) |
|---------------------------|--------|--------|----------|----------|

In the first quarter of 2014, we communicated our decision to amend certain postretirement benefits to reduce health benefits for certain current and retired employees. The impact of these changes was a reduction in accrued retiree benefit plan liabilities of \$14.7 million and we recorded actuarial losses of \$0.6 million and prior service credits of \$3.7 million. In the first quarter of 2013, we communicated our decision to amend certain postretirement benefit plans to reduce health benefits for certain current and retired employees and as a result we recognized actuarial losses of \$4.6 million in the first quarter of 2013. Liability reductions from these plan amendments are recorded as amortization of prior service cost in net income in accordance with accounting requirements. See Note 15, Accumulated Other Comprehensive Income, for information on the impact on accumulated other comprehensive income.

**10. Income Taxes**

The effective income tax rates for the three months ended March 31, 2014 and 2013 were 32.1% and 31.9%, respectively. The effective tax rate in 2014 was favorably impacted by the tax benefit associated with the anticipated year-over-year increase of the Domestic Production Activity (Internal Revenue Code Section 199) deduction. The effective tax rate in 2013 was favorably impacted by the tax benefit associated with the extension of the U.S. research and development credit under the American Taxpayer Relief Act of 2012.

It is reasonably possible that, within the next 12 months, total unrecognized tax benefits may decrease in the range of \$2 million to \$3 million, primarily as a result of the conclusion of pending U.S. federal, state and foreign income tax proceedings.

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**FORTUNE BRANDS HOME & SECURITY, INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. 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 three months ended March 31, 2014 and 2013, respectively.

| (In millions)                         | Three Months Ended March 31, |         |
|---------------------------------------|------------------------------|---------|
|                                       | 2014                         | 2013    |
| Reserve balance at January 1,         | \$ 15.2                      | \$ 14.3 |
| Provision for warranties issued       | 5.2                          | 3.9     |
| Settlements made (in cash or in kind) | (5.3)                        | (4.2)   |
| Reserve balance at March 31,          | \$ 15.1                      | \$ 14.0 |

**12. Information on Business Segments**

Net sales and operating income for the three months ended March 31, 2014 and 2013 by segment were as follows:

| (In millions)                            | Three Months Ended March 31, |           |                            |
|--|------------------------------|-----------|----------------------------|
|  | 2014                         | 2013      | % Change<br>vs. Prior Year |
| <u>Net Sales</u>                         |                              |           |                            |
| Kitchen & Bath Cabinetry                 | \$ 410.9                     | \$ 345.3  | 19.0%                      |
| Plumbing & Accessories                   | 309.9                        | 308.9     | 0.3                        |
| Advanced Material Windows & Door Systems | 130.0                        | 124.2     | 4.7                        |
| Security & Storage                       | 115.4                        | 111.6     | 3.4                        |
| Net sales                                | \$ 966.2                     | \$ 890.0  | 8.6%                       |
| <u>Operating Income (Loss)</u>           |                              |           |                            |
| Kitchen & Bath Cabinetry                 | \$ 19.9                      | \$ 14.3   | 39.2%                      |
| Plumbing & Accessories                   | 55.3                         | 55.0      | 0.5                        |
| Advanced Material Windows & Door Systems | (7.7)                        | (8.5)     | 9.4                        |
| Security & Storage                       | 9.8                          | 12.3      | (20.3)                     |
| Less: Corporate expenses                 | (15.2)                       | (16.5)    | 7.9                        |
| Operating income                         | \$ 62.1                      | \$ 56.6   | 9.7%                       |
| <u>Corporate expenses</u>                |                              |           |                            |
| General and administrative expense       | \$ (16.9)                    | \$ (14.3) |                            |
| Defined benefit plan costs               | 1.7                          | (2.2)     |                            |

|                          |           |           |      |
|--------------------------|-----------|-----------|------|
| Total Corporate expenses | \$ (15.2) | \$ (16.5) | 7.9% |
|--------------------------|-----------|-----------|------|

**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. Restructuring and Other Charges**

Pre-tax restructuring and other charges for the three months ended March 31, 2014 and 2013 are shown below.

| (In millions)            | Three Months Ended March 31, 2014 |                                 |                  |
|--------------------------|-----------------------------------|---------------------------------|------------------|
|                          | Restructuring<br>Charges          | Other<br>Charges <sup>(a)</sup> | Total<br>Charges |
| Kitchen & Bath Cabinetry | \$ 0.1                            | \$                              | \$ 0.1           |
| Plumbing & Accessories   | 0.1                               |                                 | 0.1              |
| Security & Storage       | 2.1                               | 0.1                             | 2.2              |
| <b>Total</b>             | <b>\$ 2.3</b>                     | <b>\$ 0.1</b>                   | <b>\$ 2.4</b>    |

| (In millions)                            | Three Months Ended March 31, 2013 |                                 |                  |
|--|-----------------------------------|---------------------------------|------------------|
|  | Restructuring<br>Charges          | Other<br>Charges <sup>(a)</sup> | Total<br>Charges |
| Kitchen & Bath Cabinetry                 | \$ 0.3                            | \$ 0.3                          | \$ 0.6           |
| Advanced Material Windows & Door Systems | 0.6                               |                                 | 0.6              |
| <b>Total</b>                             | <b>\$ 0.9</b>                     | <b>\$ 0.3</b>                   | <b>\$ 1.2</b>    |

<sup>(a)</sup> *Other Charges* represent charges directly related to restructuring initiatives that cannot be reported as restructuring under U.S. GAAP. Such costs may include losses on disposal of inventories, trade receivables allowances from exiting product lines, accelerated depreciation resulting from the closure of facilities and gains or losses on the sale of previously closed facilities.

Restructuring and other charges in the first quarter of 2014 resulted from product line rationalization in the storage product line within our Security & Storage segment. The Company's restructuring liability was not material as of March 31, 2014 and December 31, 2013.

**14. Earnings Per Share**

The computations of earnings per common share were as follows:

| (In millions, except per share data)       | Three Months Ended<br>March 31, |         |
|--|---------------------------------|---------|
|  | 2014                            | 2013    |
| Net income attributable to Home & Security | \$ 40.8                         | \$ 37.3 |

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|  |         |         |
|--|---------|---------|
| Basic earnings per common share  | \$ 0.25 | \$ 0.23 |
| Diluted earnings per common share  | \$ 0.24 | \$ 0.22 |
| Basic average shares outstanding   | 166.2   | 164.3   |
| Stock-based awards   | 5.0     | 6.0     |
| Diluted average shares outstanding   | 171.2   | 170.3   |
| Antidilutive stock-based awards excluded from weighted-average number of shares outstanding for diluted earnings per share | 0.2     | 0.7     |

**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**15. Accumulated Other Comprehensive Income**

Total accumulated other comprehensive income consists of net income and other changes in business equity from transactions and other events from sources other than shareholders. It includes currency translation gains and losses, unrealized gains and losses from derivative instruments designated as cash flow hedges, and defined benefit plan adjustments. The components of and changes in accumulated other comprehensive income, net of tax, were as follows:

| (In millions)  | Foreign<br>Currency<br>Adjustments | Derivative<br>Hedging<br>Gains | Defined<br>Benefit Plan<br>Adjustments | Accumulated<br>Other<br>Comprehensive<br>Income |
|--|------------------------------------|--------------------------------|--|---|
| Balance at December 31, 2013                                     | \$ 53.3                            | \$ 0.9                         | \$ 41.2                                | \$ 95.4   |
| Amounts classified into accumulated other comprehensive income   | (9.8)                              | (0.2)                          | 9.2 <sup>(a)</sup>                     | (0.8)   |
| Amounts reclassified from accumulated other comprehensive income |                                    | (0.6)                          | (6.2)                                  | (6.8)   |
| Net current-period other comprehensive income                    | (9.8)                              | (0.8)                          | 3.0                                    | (7.6)   |
| Balance at March 31, 2014  | \$ 43.5                            | \$ 0.1                         | \$ 44.2                                | \$ 87.8   |

<sup>(a)</sup> See Note 9, *Defined Benefit Plans*, for further information on the adjustments related to defined benefit plans.

The reclassifications out of accumulated other comprehensive income for the three months ended March 31, 2014 and 2013 were as follows:

| (In millions)  | Amount Reclassified from<br>Accumulated Other Comprehensive Income |        |  | Affiliated<br>Entity | Line Item in<br>the Statement of<br>Comprehensive<br>Income |
|--|--|--------|--|----------------------|---|
| Details about Accumulated Other<br>Comprehensive Income Components | Three Months<br>Ended<br>March 31,                                 |        |  |                      |   |
|  | 2014   | 2013   |  |                      |   |
| <u>Gains on cash flow hedges</u>                                   |  |        |  |                      |   |
| Foreign exchange contracts   | \$ 0.7   | \$ 0.4 |  |                      | Cost of products sold                                       |
|  | (0.1)  | (0.1)  |  |                      | Tax expense   |
|  | \$ 0.6   | \$ 0.3 |  |                      | Net of tax  |

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| <u>Defined benefit plan items</u>             |               |               |                   |
|---|---------------|---------------|-------------------|
| Recognition of prior service cost             | \$ 10.6       | \$ 7.0        | (a)               |
| Recognition of actuarial losses               | (0.6)         | (4.6)         | (a)               |
|   | 10.0          | 2.4           | Total before tax  |
|   | (3.8)         | (1.1)         | Tax expense       |
|   | \$ 6.2        | \$ 1.3        | Net of tax        |
| <b>Total reclassifications for the period</b> | <b>\$ 6.8</b> | <b>\$ 1.6</b> | <b>Net of tax</b> |

<sup>(a)</sup> *These accumulated other comprehensive income components are included in the computation of net periodic benefit cost. Refer to Note 9, Defined Benefit Plans, for additional information.*



**FORTUNE BRANDS HOME & SECURITY, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)**

**16. Contingencies**

**Litigation**

We are defendants in lawsuits associated with the normal conduct of our businesses and operations. It is not possible to predict the outcome of the pending actions, and, as with any litigation, it is possible that these actions could be decided unfavorably to the Company. The Company believes that there are meritorious defenses to these actions and that these actions will not have a material adverse effect upon our results of operations, cash flows or financial condition, and where appropriate, these actions are being vigorously contested.

**Environmental**

Compliance with federal, state and local laws regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, did not have a material effect on capital expenditures, earnings or the competitive position of Home & Security during the three months ended March 31, 2014 and 2013. We are involved in remediation activities to clean up hazardous wastes as required by federal and state laws. Liabilities for remediation costs of each site are based on our best estimate of undiscounted future costs, excluding possible insurance recoveries or recoveries from other third parties. Uncertainties about the status of laws, regulations, technology and information related to individual sites make it difficult to develop estimates of environmental remediation exposures.

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**Item 2. FORTUNE BRANDS HOME & SECURITY, INC.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS OF**  
**FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and the notes thereto, which are included in this report, as well as our audited consolidated financial statements for the year ended December 31, 2013, which are included in our Annual Report on Form 10-K for the year ended December 31, 2013.

This discussion contains forward-looking statements that are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Act of 1934 (the "Exchange Act"), as amended, regarding business strategies, market potential, future financial performance and other matters. Statements preceded by, followed by or that otherwise include the words "believes," "expects," "anticipates," "intends," "projects," "estimates," "plans" and similar expressions or future or conditional verbs such as "will," "should," "would," "could" are generally forward-looking in nature and not historical facts. The forward-looking statements are not historical facts, but rather are based on expectations, estimates, assumptions and projections about our industry, business and future financial results, based on information available at the time this report is filed with the Securities and Exchange Commission, or with respect to any document incorporated by reference, available as of the time such document was prepared. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including but not limited to: (i) by our reliance on the North American home improvement, repair and new home construction activity levels, (ii) the North American and global economies, (iii) risk associated with entering into potential strategic acquisitions and integrating acquired property, (iv) our ability to remain competitive, innovative and protect our intellectual property, (v) our reliance on key customers and suppliers, (vi) the cost and availability associated with our supply chains and the availability of raw materials, (vii) risk of increases in our postretirement benefit-related costs and funding requirements, (viii) compliance with tax, environmental and federal, state and international laws and industry regulatory standards and (ix) the risk of doing business internationally. These and other factors are discussed in Part I, Item 1A "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2013, which is hereby incorporated herein by reference. We undertake no obligation to, and expressly disclaim any such obligation to, update or clarify any forward-looking statements to reflect changed assumptions, the occurrence of anticipated or unanticipated events, new information or changes to future results over time or otherwise, except as required by law.

**OVERVIEW**

References to "Home & Security," "the Company," "we," "our" and "us" refer to Fortune Brands Home & Security, Inc. and its consolidated subsidiaries as a whole, unless the context otherwise requires. The Company is a leader in home and security products focused on the design, manufacture and sale of market-leading branded products in the following categories: kitchen and bath cabinetry, plumbing and accessories, advanced material windows products and entry door systems and security and storage products.

**OVERVIEW (Continued)**

We believe the Company has certain competitive advantages including market-leading brands, a diversified mix of channels, and lean and flexible supply chains, as well as a tradition of strong innovation and customer service. We are focused on outperforming our markets in growth, profitability and returns in order to drive increased shareholder value. We believe the Company's track record reflects the long-term attractiveness and potential of our categories and our leading brands. As consumer demand and the housing market improve from current levels, we expect the benefits of operating leverage and strategic spending will help us continue to achieve profitable organic growth.

We believe our most attractive opportunities are to invest in profitable organic growth initiatives. We also believe that as the market recovers, we have the potential to generate additional growth from leveraging our cash flow and balance sheet strength by pursuing accretive strategic acquisitions and returning cash to shareholders through a combination of dividends and repurchases under our share repurchase programs as explained in further detail under Liquidity and Capital Resources below.

The U.S. market for our home products consists of spending on both new home construction and repair and remodel activities within existing homes, with the substantial majority of the markets we serve consisting of repair and remodel spending. We believe that the U.S. market for our home products is in the early stages of a multi-year recovery and that a continued recovery will largely depend on consumer confidence, employment, home prices and credit availability. Over the long term, we believe that the U.S. home products market will benefit from favorable population and immigration trends, which will drive demand for new housing units, and from aging existing housing stock that will continue to need to be repaired and remodeled.

We may be impacted by fluctuations in raw material and transportation costs and promotional activity among our competitors. We strive to offset the potential unfavorable impact of these items with productivity initiatives and price increases.

In June 2013, our Kitchen & Bath Cabinetry business acquired WoodCrafters Home Products Holding, LLC (WoodCrafters), a manufacturer of bathroom vanities and tops. The financial results of WoodCrafters are included in the Company's results of operations and cash flows beginning in the third quarter of 2013.

**RESULTS OF OPERATIONS****Three Months Ended March 31, 2014 Compared To Three Months Ended March 31, 2013**

| (In millions)                            | Net Sales |          |                            |
|--|-----------|----------|----------------------------|
|  | 2014      | 2013     | % Change<br>vs. Prior Year |
| Kitchen & Bath Cabinetry                 | \$ 410.9  | \$ 345.3 | 19.0%                      |
| Plumbing & Accessories                   | 309.9     | 308.9    | 0.3                        |
| Advanced Material Windows & Door Systems | 130.0     | 124.2    | 4.7                        |
| Security & Storage                       | 115.4     | 111.6    | 3.4                        |
| Net sales                                | \$ 966.2  | \$ 890.0 | 8.6%                       |

  

|  | Operating Income (Loss) |         |                               |
|--|-------------------------|---------|-------------------------------|
|  | 2014                    | 2013    | % Change<br>vs. Prior<br>Year |
| Kitchen & Bath Cabinetry                 | \$ 19.9                 | \$ 14.3 | 39.2%                         |
| Plumbing & Accessories                   | 55.3                    | 55.0    | 0.5                           |
| Advanced Material Windows & Door Systems | (7.7)                   | (8.5)   | 9.4                           |
| Security & Storage                       | 9.8                     | 12.3    | (20.3)                        |
| Less: Corporate expenses                 | (15.2)                  | (16.5)  | 7.9                           |
| Operating income                         | \$ 62.1                 | \$ 56.6 | 9.7%                          |

The following discussion of consolidated results of operations and segment results refers to the three months ended March 31, 2014 compared to the three months ended March 31, 2013. Consolidated results of operations should be read in conjunction with segment results of operations.

*Net sales*

Net sales increased \$76.2 million, or 9%. The increase was due to the benefit of the acquisition of WoodCrafters (approximately \$50 million), higher sales volume primarily from the continuing improvement in U.S. market conditions for home products, and price increases to help mitigate material cost increases. These increases were partially offset by the impact of extreme weather in certain regions of the U.S., which we estimate unfavorably impacted net sales by approximately \$40 million.

*Cost of products sold*

Cost of products sold increased \$61.7 million, or 10%, due to higher sales volume, inefficiencies related to weather, and investments to support increased manufacturing capacity and long-term growth initiatives, partially offset by the benefit of productivity improvements.

*Selling, general and administrative expenses*

Selling, general and administrative expenses increased \$6.2 million, or 3%, due to planned increases in strategic spending to support increased capacity and long-term growth initiatives.



**RESULTS OF OPERATIONS (Continued)**

*Amortization of intangible assets*

Amortization of intangible assets increased \$1.4 million due amortization of identifiable intangible assets associated with the WoodCrafters acquisition.

*Restructuring charges*

Restructuring charges of \$2.3 million in the three months ended March 31, 2014 related to product line rationalization in the storage product line within our Security & Storage segment. Restructuring charges of \$0.9 million in the three months ended March 31, 2013 related to supply chain initiatives.

*Operating income*

Operating income increased \$5.5 million, or 10%, primarily due to higher sales volume from our growth initiatives, improving U.S. home products market conditions and benefit from the WoodCrafters acquisition. We estimate the impact of lower sales volume and operating inefficiencies from extreme weather in certain regions of the U.S. unfavorably impacted our results by approximately \$20 million. We estimate the acquisition of WoodCrafters benefited operating income by approximately \$5 million.

*Interest expense*

Interest expense increased \$0.2 million to \$1.9 million due to higher average borrowings, partially offset by lower average interest rates.

*Other income, net*

Other income, net, was \$0.5 million in the three months ended March 31, 2014, compared to \$0.2 million in the three months ended March 31, 2013.

*Income taxes*

The effective income tax rates for the three months ended March 31, 2014 and 2013 were 32.1% and 31.9%, respectively. The effective tax rate in 2014 was favorably impacted by the tax benefit associated with the anticipated year-over-year increase of the Domestic Production Activity (Internal Revenue Code Section 199) deduction. The effective tax rate in 2013 was favorably impacted by the tax benefit associated with the extension of the U.S. research and development credit under the American Taxpayer Relief Act of 2012.

*Noncontrolling interests*

Noncontrolling interest was \$0.4 million and \$0.2 million in the three months ended March 31, 2014 and 2013, respectively.

*Net income attributable to Home & Security*

Net income attributable to Home & Security was \$40.8 million in the three months ended March 31, 2014 compared to \$37.3 million in the three months ended March 31, 2013. The increase of \$3.5 million was primarily due to higher operating income.



## **RESULTS OF OPERATIONS (Continued)**

### **Results By Segment**

#### **Kitchen & Bath Cabinetry**

Net sales increased \$65.6 million, or 19%, due to the benefit of the acquisition of WoodCrafters and from strength in repair and remodel volume, favorable product mix and price increases to help mitigate raw material increases. Net sales were unfavorably affected by extreme weather in certain regions of the U.S. during the first quarter of 2014.

Operating income increased \$5.6 million, or 39%, due to the acquisition of WoodCrafters. Operating income also benefited from price increases, improved product mix and productivity improvements. Operating income was unfavorably impacted by lower sales and operating inefficiencies caused by extreme weather in certain regions of the U.S., increased costs for raw materials (wood-related) and investments to support manufacturing capacity increases for long-term growth.

#### **Plumbing & Accessories**

Net sales increased \$1.0 million due to higher sales volume in the U.S. driven primarily by improving U.S. market conditions and approximately \$5 million in higher sales in China, offset by the adverse impact of weather in certain regions of the U.S. and lower sales in Canada.

Operating income increased \$0.3 million, or 1%. Benefits from cost saving initiatives were offset by the impact of extreme weather in certain regions of the U.S. and planned strategic and supply chain initiatives to increase capacity for long-term growth.

#### **Advanced Material Windows & Door Systems**

Net sales increased \$5.8 million, or 5%, due to higher sales volume of door systems driven primarily by improved conditions in the U.S. home products market and favorable product mix, partially offset by the adverse impact of weather in certain regions of the U.S. Net sales of door systems grew \$5.9 million, or 8%, while net sales of window products were flat.

The operating loss of \$7.7 million decreased by \$0.8 million, or 9%, due to the absence of 2013 restructuring charges of \$0.6 million. The benefits from higher net sales and cost savings initiatives were offset by costs related to capacity investments and inefficiencies from extreme weather.

#### **Security & Storage**

Net sales increased \$3.8 million, or 3%. Net sales of security products increased \$3.2 million, or 4%, due to higher retail and international sales volume. Net sales of storage products increased \$0.6 million, or 2%, due to higher sales volume, partially offset by higher promotional costs.

Operating income decreased \$2.5 million, or 20%, due to \$2.2 million in restructuring and other charges primarily related to product line rationalization in the storage product line. Operating income benefits from higher net sales were offset by higher promotional costs, unfavorable product mix and higher administrative expenses.





**RESULTS OF OPERATIONS (Continued)****Corporate**

Corporate expenses decreased \$1.3 million due to lower actuarial losses (\$4.0 million) recognized in the first quarter of 2014 compared to 2013 that related to defined benefit plan amendments that required a remeasurement of certain postretirement benefit liabilities. General and administrative expenses increased \$2.6 million primarily due to higher information technology costs and the timing of certain group insurance expenses.

| (In millions)  | Three Months Ended<br>March 31, |           |
|--|---------------------------------|-----------|
|  | 2014                            | 2013      |
| General and administrative expense                   | \$ (16.9)                       | \$ (14.3) |
| Defined benefit plan income                          | 2.3                             | 2.4       |
| Defined benefit plan recognition of actuarial losses | (0.6)                           | (4.6)     |
| Total Corporate expenses                             | \$ (15.2)                       | \$ (16.5) |

In future periods the Company may record, in the Corporate segment, material expense or income associated with actuarial gains and losses arising from periodic remeasurement of our liabilities for defined benefit plans. At a minimum the Company will remeasure its defined benefit plan liabilities in the fourth quarter of each year. Remeasurements due to plan amendments and settlements may also occur in interim periods during the year. Remeasurement of these liabilities attributable to updating our liability discount rates and expected return on assets may, in particular, result in material income or expense recognition.

**LIQUIDITY AND CAPITAL RESOURCES**

Our primary liquidity needs are to support working capital requirements, fund capital expenditures and service indebtedness, as well as to finance acquisitions, repurchase shares of our common stock and pay dividends to stockholders, as deemed appropriate. Our principal sources of liquidity have been cash on hand, cash flows from operating activities and availability under our credit facilities. Our operating income is generated by our subsidiaries. There are no restrictions on the ability of our subsidiaries to pay dividends or make other distributions to Home & Security. In 2013, our Board of Directors declared a regular cash dividend of \$0.10 per share of our outstanding common stock that was increased to \$0.12 per share of our outstanding common stock beginning with the dividend payable in the first quarter of 2014.

On July 25, 2012, our Board of Directors approved a share repurchase program (the 2012 Program ) that authorizes the Company to repurchase up to \$150 million of shares of our outstanding common stock over the three years ending July 25, 2015. On February 25, 2014, our Board of Directors approved a second repurchase program that authorizes the Company to repurchase up to an additional \$150 million of shares of our outstanding common stock over the two years ending February 25, 2016. In the first quarter of 2014, we repurchased 1,555,700 shares of our outstanding common stock under the 2012 Program for \$68.7 million. As of March 31, 2014, the Company's total remaining share repurchase authorization under both programs was \$170.5 million. The share repurchase programs do not obligate the Company to repurchase any specific dollar amount or number of shares and may be suspended or discontinued at any time.



In June 2013, our Kitchen & Bath Cabinetry business acquired WoodCrafters, a manufacturer of bathroom vanities and tops, for a purchase price of approximately \$302 million, subject to certain post-closing adjustments. The Company paid the purchase price using a combination of cash on hand and borrowings under our existing credit facilities.

We periodically review our portfolio of brands and evaluate potential strategic transactions to increase shareholder value. However, we cannot predict whether or when we may enter into acquisitions, joint ventures or dispositions, make any purchases of shares of our common stock under our share repurchase programs, or pay dividends, or what impact any such transactions could have on our results of operations, cash flows or financial condition, whether as a result of the issuance of debt or equity securities, or otherwise. Our cash flows from operations, borrowing availability and overall liquidity are subject to certain risks and uncertainties, including those described in the section of our Annual Report on Form 10-K for the year-ended December 31, 2013 entitled Item 1A. Risk Factors.

On March 31, 2014, we had cash and cash equivalents of \$124.2 million, of which \$113.8 million was held at non-U.S. subsidiaries. We manage our global cash requirements considering (i) available funds among the subsidiaries through which we conduct business, (ii) the geographic location of our liquidity needs, and (iii) the cost to access international cash balances. The repatriation of non-U.S. cash balances from certain subsidiaries could have adverse tax consequences as we may be required to pay and record income tax expense on those funds to the extent they were previously considered indefinitely reinvested.

Our operating cash flows are significantly impacted by the seasonality of our business. We typically generate our operating cash flow in the third and fourth quarters of each year. We use operating cash in the first half of the year, particularly in the first quarter.

We have a \$650 million committed revolving credit facility, as well as a \$350 million term loan, both of which expire in July 2018. Both facilities are to be used for general corporate purposes. On March 31, 2014 and December 31, 2013, our outstanding borrowings under these facilities were \$475.0 million and \$350.0 million, respectively. 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%. At March 31, 2014, we were in compliance with all covenants under these facilities.

### **Cash Flows**

Below is a summary of cash flows for the three months ended March 31, 2014 and 2013.

| (In millions)                                   | Three Months Ended March 31, |           |
|---|------------------------------|-----------|
|   | 2014                         | 2013      |
| Net cash used in operating activities           | \$ (156.6)                   | \$ (72.5) |
| Net cash used in investing activities           | (20.9)                       | (14.2)    |
| Net cash provided by financing activities       | 62.0                         | 9.9       |
| Effect of foreign exchange rate changes on cash | (1.7)                        | (0.3)     |
| Net decrease in cash and cash equivalents       | \$ (117.2)                   | \$ (77.1) |

Net cash used in operating activities was \$156.6 million in the three months ended March 31, 2014 compared to \$72.5 million in the three months ended March 31, 2013. The increase in cash used of \$84.1 million was primarily due to higher incentive compensation and customer program payments in the first quarter of 2014 compared to 2013 (approximately \$35 million in aggregate), as well as higher working capital levels to support higher sales.

Net cash used in investing activities was \$20.9 million in the three months ended March 31, 2014 compared to \$14.2 million in the three months ended March 31, 2013. The increase of \$6.7 million was due to higher capital spending.

Net cash provided by financing activities was \$62.0 million in the three months ended March 31, 2014 compared to \$9.9 million in the three months ended March 31, 2013. The increase in cash provided of \$52.1 million was primarily due to higher net borrowings of \$127.7 million and the excess tax benefit on the exercise of stock-based compensation (\$8.2 million), partially offset by higher stock purchases in 2014 compared to 2013 (\$55.2 million), the 2014 dividend of \$19.9 million and lower proceeds from the exercise of stock options (\$8.7 million).

### **Pension Plans**

Subsidiaries of Home & Security sponsor their respective defined benefit pension plans that are funded by a portfolio of investments maintained within our benefit plan trust. As of December 31, 2013, the fair value of our total pension plan assets was \$583.8 million, representing 90% of the accumulated benefit obligation liability. In 2014, we expect to make pension contributions of approximately \$10 million. For the foreseeable future, we believe that we have sufficient liquidity to meet the minimum funding that may be required by the Pension Protection Act of 2006.

### **Foreign Exchange**

We have investments in various foreign countries, principally Canada, Mexico, China and France. Therefore, changes in the value of the related currencies affect our financial statements when translated into U.S. dollars.

**RECENTLY ISSUED ACCOUNTING STANDARDS**

*Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

In April 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This standard changes the definition of discontinued operations and requires expanded disclosures. The amendment is effective for annual periods beginning on or after December 15, 2014 (calendar 2015 for Home & Security). Early adoption is permitted. We do not expect this standard to have a material effect on our financial statements.

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

There have been no material changes in the information provided in the section entitled "Quantitative and Qualitative Disclosures about Market Risk" in our Annual Report on Form 10-K for the year ended December 31, 2013.

**Item 4. CONTROLS AND PROCEDURES.**

**(a) Evaluation of Disclosure Controls and Procedures.**

The Company's management has evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

**(b) Changes in Internal Control Over Financial Reporting.**

There have not been any changes in the Company's internal control over financial reporting that occurred during the Company's fiscal quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. The Company is in the process of reviewing the internal control structure of acquired businesses and, if necessary, will make appropriate changes as we incorporate our controls and procedures into those recently acquired businesses.

**PART II. OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS.****(a) Other Litigation.**

The Company is a defendant in lawsuits associated with the normal conduct of its businesses and operations. It is not possible to predict the outcome of the pending actions, and, as with any litigation, it is possible that these actions could be decided unfavorably to the Company. The Company believes that there are meritorious defenses to these actions and that these actions will not have a material adverse effect upon the Company's results of operations, cash flows or financial condition, and, where appropriate, these actions are being vigorously contested.

**(b) Environmental Matters.**

We are subject to laws and regulations relating to protection of the environment. It is not possible to quantify with certainty the potential impact of actions relating to environmental matters, particularly remediation and other compliance efforts that our subsidiaries may undertake in the future. In our opinion, however, compliance with current environmental protection laws (before taking into account estimated recoveries from third parties) will not have a material adverse effect upon our results of operations, cash flows or financial condition.

**Item 1A. RISK FACTORS.**

There have been no material changes to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013 in the section entitled Risk Factors.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

Below are the repurchases of common stock by the Company or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Exchange Act) for the three months ended March 31, 2014:

**Issuer Purchases of Equity Securities**

| Three Months Ended     | Total number of shares purchased <sup>(a)</sup> | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs <sup>(a)</sup> | Maximum dollar amount that may yet be purchased under the plans or programs <sup>(a)</sup> |
|------------------------|---|------------------------------|---|--|
| March 31, 2014         |   |                              |   |  |
| January 1 - January 31 | 280,000   | \$ 44.36                     | 280,000   | \$ 76,750,722  |



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|            |             |           |          |           |             |
|------------|-------------|-----------|----------|-----------|-------------|
| February 1 | February 28 | 1,275,700 | 44.07    | 1,275,700 | 170,528,972 |
| March 1    | March 31    |           |          |           | 170,528,972 |
| Total      |             | 1,555,700 | \$ 44.12 | 1,555,700 |             |

(a) *The Company purchased 1,555,700 shares between January 1, 2014 and February 28, 2014 pursuant to the Company's share repurchase program approved by the Company's Board of Directors on July 25, 2012 and announced on July 26, 2012 that authorizes repurchases up to \$150 million of shares of our outstanding common stock through July 25, 2015 and the Company's share repurchase program approved and announced by the Company's Board of Directors on February 25, 2014 that authorizes the repurchase of \$150 million of additional shares of our outstanding common stock through February 25, 2016.*

**Item 6. EXHIBITS**

- 3(i). Restated Certificate of Incorporation of Fortune Brands Home & Security, Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed with the SEC on November 5, 2012, Commission file number 1-35166).
- 3(ii). Amended and Restated By-laws of Fortune Brands Home & Security, Inc., as adopted September 27, 2011 (incorporated herein by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on September 30, 2011, Commission file number 1-35166).
- 31.1.\* Certificate of Chief Executive Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2.\* Certificate of Chief Financial Officer Required Under Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.\* Joint CEO/CFO Certificate Required Under Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.\* The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 formatted in eXtensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Comprehensive Income, (ii) the Condensed Consolidated Balance Sheets, (iii) the Condensed Consolidated Statements of Cash Flows, (iv) the Condensed Consolidated Statements of Equity, and (v) the Notes to the Condensed Consolidated Financial Statements.

\* Filed herewith.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**FORTUNE BRANDS HOME & SECURITY, INC.**  
(Registrant)

Date: May 1, 2014

/s/ E. Lee Wyatt, Jr.  
E. Lee Wyatt, Jr.  
Senior Vice President and Chief Financial Officer  
(Duly authorized officer and principal financial officer  
of the Registrant)

**EXHIBIT INDEX**

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