

Fortune Brands Home & Security, Inc.
Form 10-Q
July 31, 2013

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 June 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)

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DELAWARE
(State or other jurisdiction of

62-1411546
(I.R.S. Employer

incorporation or organization)

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 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 July 24, 2013 was 166,006,338.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.**FORTUNE BRANDS HOME & SECURITY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Six and Three Months Ended June 30, 2013 and 2012**

(In millions, except per share amounts)

(Unaudited)

	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
Net sales	\$ 1,930.4	\$ 1,734.1	\$ 1,040.4	\$ 935.3
Cost of products sold	1,253.2	1,169.9	663.4	617.9
Selling, general and administrative expenses	507.8	463.4	267.7	242.3
Amortization of intangible assets	5.1	6.2	2.5	2.8
Restructuring charges	1.2	1.0	0.3	
Operating income	163.1	93.6	106.5	72.3
Interest expense	3.4	4.6	1.7	2.1
Other expense, net	5.9	0.2	6.1	0.7
Income before income taxes	153.8	88.8	98.7	69.5
Income tax provision	52.1	27.9	34.5	21.6
Net income	101.7	60.9	64.2	47.9
Less: Noncontrolling interests	0.4	0.6	0.2	0.1
Net income attributable to Home & Security	\$ 101.3	\$ 60.3	\$ 64.0	\$ 47.8
Basic earnings per common share	\$ 0.61	\$ 0.38	\$ 0.39	\$ 0.30
Diluted earnings per common share	\$ 0.59	\$ 0.37	\$ 0.37	\$ 0.29
Comprehensive income	\$ 123.2	\$ 60.8	\$ 58.6	\$ 43.4

See notes to condensed consolidated financial statements.

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

(In millions)

(Unaudited)

	June 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	\$ 123.6	\$ 336.0
Accounts receivable, net	499.8	381.7
Inventories	438.8	357.2
Other current assets	141.4	153.0
Total current assets	1,203.6	1,227.9
Property, plant and equipment, net	522.2	509.4
Goodwill	1,521.8	1,381.4
Other intangible assets, net of accumulated amortization	764.6	683.6
Other assets	53.2	71.6
Total assets	\$ 4,065.4	\$ 3,873.9
Liabilities and equity		
Current liabilities		
Notes payable to banks	\$ 6.1	\$ 5.5
Current portion of long-term debt	22.5	22.5
Accounts payable	350.1	287.0
Other current liabilities	293.0	317.4
Total current liabilities	671.7	632.4
Long-term debt	357.5	297.5
Deferred income taxes	230.0	224.0
Accrued defined benefit plans	196.0	252.7
Other non-current liabilities	81.8	82.6
Total liabilities	1,537.0	1,489.2
Equity		
Home & Security stockholders' equity		
Common stock ^(a)	1.6	1.6
Paid-in capital	2,380.1	2,324.8
Accumulated other comprehensive income	52.1	30.6
Retained earnings	125.8	41.0
Treasury stock	(34.1)	(16.9)
Total Home & Security stockholders' equity	2,525.5	2,381.1
Noncontrolling interests	2.9	3.6
Total equity	2,528.4	2,384.7
Total liabilities and equity	\$ 4,065.4	\$ 3,873.9

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^(a) *Common stock, par value \$0.01 per share; 167.1 million shares and 164.6 million shares issued at June 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 Six Months Ended June 30, 2013 and 2012

(In millions)

(Unaudited)

	2013	2012
Operating activities		
Net income	\$ 101.7	\$ 60.9
Non-cash pre-tax expense:		
Depreciation	37.7	41.3
Amortization	5.1	6.2
Stock-based compensation	13.8	13.4
Recognition of actuarial losses	5.4	
Asset impairment charge	6.2	
Deferred income taxes	4.9	9.6
Changes in assets and liabilities:		
Increase in accounts receivable	(81.3)	(60.3)
Increase in inventories	(56.5)	(48.8)
Increase in accounts payable	47.8	27.5
Decrease in other assets	12.9	7.2
Decrease in accrued expenses and other liabilities	(66.2)	(1.5)
Increase (decrease) in accrued taxes	14.4	(3.0)
Net cash provided by operating activities	45.9	52.5
Investing activities		
Capital expenditures	(31.2)	(28.2)
Proceeds from the disposition of assets	0.3	1.8
Cost of acquisition, net of cash	(299.4)	
Other investing activities		(3.6)
Net cash used in investing activities	(330.3)	(30.0)
Financing activities		
Increase in short-term debt, net	1.1	1.1
Issuance of long-term debt	180.0	70.0
Repayment of long-term debt	(120.0)	(120.0)
Proceeds from the exercise of stock options	28.8	54.8
Payment to Beam Inc.		(6.0)
Treasury stock purchases	(13.5)	
Tax benefit on exercise of stock options	13.1	4.1
Dividends to stockholders	(16.5)	
Other financing, net	(1.1)	(1.1)
Net cash provided by financing activities	71.9	2.9
Effect of foreign exchange rate changes on cash	0.1	1.0
Net (decrease) increase in cash and cash equivalents	\$ (212.4)	\$ 26.4

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Cash and cash equivalents at beginning of period	\$ 336.0	\$ 120.8
Cash and cash equivalents at end of period	\$ 123.6	\$ 147.2

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

For the Six Months Ended June 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				60.3		0.6	60.9
Other comprehensive income			(0.1)				(0.1)
Stock options exercised		54.8					54.8
Stock-based compensation		13.5			(3.8)		9.7
Tax benefit on exercise of stock options		5.0					5.0
Separation-related adjustments		(3.5)					(3.5)
Dividends paid to noncontrolling interests						(1.1)	(1.1)
Balance at June 30, 2012	\$ 1.6	\$ 2,256.2	\$ 10.5	\$ (17.4)	\$ (3.9)	\$ 3.2	\$ 2,250.2
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				101.3		0.4	101.7
Other comprehensive income			21.5				21.5
Stock options exercised		28.8					28.8
Stock-based compensation		13.4			(4.1)		9.3
Tax benefit on exercise of stock options		13.1					13.1
Treasury stock purchase					(13.1)		(13.1)
Dividends (\$0.10 per Common share)				(16.5)			(16.5)
Dividends paid to noncontrolling interests						(1.1)	(1.1)
Balance at June 30, 2013	\$ 1.6	\$ 2,380.1	\$ 52.1	\$ 125.8	\$ (34.1)	\$ 2.9	\$ 2,528.4

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 June 30, 2013, the related condensed consolidated statements of comprehensive income for the six-month and three-month periods ended June 30, 2013 and 2012 and the related condensed consolidated statements of cash flows and equity for the six-month periods ended June 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)	June 30, 2013	December 31, 2012
Inventories:		
Raw materials and supplies	\$ 176.8	\$ 144.3
Work in process	40.6	38.6
Finished products	221.4	174.3
Total inventories	\$ 438.8	\$ 357.2
Property, plant and equipment, gross	\$ 1,523.9	\$ 1,491.2
Less: accumulated depreciation	1,001.7	981.8
Property, plant and equipment, net	\$ 522.2	\$ 509.4

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 \$300 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 will greatly expand our offerings of bathroom cabinetry products.

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**4. Acquisitions (Continued)**

The following table summarizes a 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)	
Cash	\$ 0.6
Accounts receivable	38.8
Inventories	25.4
Property, plant and equipment	21.9
Goodwill	143.1
Identifiable intangible assets	91.4
Other assets	7.9
Total assets	329.1
Other current liabilities and accruals	29.1
Net assets acquired	\$ 300.0

All of the acquired goodwill is tax deductible. The useful lives of the identifiable intangible assets are expected to range from 3 to 20 years.

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.

(In millions)	Six Months Ended June 30,		Three Months Ended June 30,	
	2013	2012	2013	2012
Net sales	\$ 2,037.7	\$ 1,817.4	\$ 1,090.4	\$ 979.6
Net income attributable to Home & Security	109.9	60.0	68.1	49.2
Basic earnings per common share	\$ 0.67	\$ 0.38	\$ 0.41	\$ 0.31
Diluted earnings per common share	\$ 0.64	\$ 0.37	\$ 0.40	\$ 0.30

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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	143.1				143.1
Year-to-date translation adjustments	(1.7)			(1.0)	(2.7)
Goodwill at June 30, 2013 ^(a)	\$ 633.2	\$ 569.7	\$ 229.1	\$ 89.8	\$ 1,521.8

^(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 \$89.0 million was principally due to a preliminary allocation of identifiable intangible assets associated with the acquisition of WoodCrafters.

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

(In millions)	As of June 30, 2013			As of December 31, 2012		
	Gross Carrying Amounts	Accumulated Amortization	Net Book Value	Gross Carrying Amounts	Accumulated Amortization	Net Book Value
Indefinite-lived tradenames	\$ 598.9	\$ (42.0) ^(a)	\$ 556.9	\$ 603.4	\$ (42.0) ^(a)	\$ 561.4
Amortizable intangible assets						
Tradenames	23.6	(7.1)	16.5	17.8	(6.9)	10.9
Customer and contractual relationships	347.7	(176.7)	171.0	274.2	(174.4)	99.8
Patents/proprietary technology	62.3	(42.1)	20.2	52.6	(41.1)	11.5
Total	433.6	(225.9)	207.7	344.6	(222.4)	122.2
Total identifiable intangibles	\$ 1,032.5	\$ (267.9)	\$ 764.6	\$ 948.0	\$ (264.4)	\$ 683.6

^(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 Other Identifiable Intangible Assets (Continued)

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 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.

In the first half 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.

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. In July 2013, these facilities were renewed under essentially the same terms and co