MASCO CORP /DE/
Form 10-Q
October 25, 2016

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 September 30, 2016

Commission file number: 1-5794

Masco Corporation
(Exact name of Registrant as Specified in its Charter)

Delaware	38-1794485
(State of Incorporation)	(IRS Employer Identification No.)

21001 Van Born Road, Taylor, Michigan	48180
(Address of Principal Executive Offices)	(Zip Code)

(313) 274-7400
(Registrant's telephone number, including area code)

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. x Yes o No

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding at September 30, 2016
Common stock, par value $1.00 per share	328,307,161

MASCO CORPORATION

INDEX

		Page No.
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements (Unaudited):	
	Condensed Consolidated Balance Sheets — as at September 30, 2016 and December 31, 2015	1
	Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2016 and 2015	2
	Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2016 and 2015	3
	Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2016 and 2015	4
	Consolidated Statements of Shareholders' Equity for the Nine Months Ended September 30, 2016 and 2015	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	20
Item 4.	Controls and Procedures	26
PART II.	OTHER INFORMATION	27
Item 1.	Legal Proceedings	
Item 1A.	Risk Factors	
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	
Item 6.	Exhibits	
	Signature	

Table of Contents
MASCO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

September 30, 2016 and December 31, 2015
(In Millions, Except Share Data)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash investments	$ 1,041	$ 1,468
Short-term bank deposits	182	248
Receivables	1,054	853
Prepaid expenses and other	87	72
Inventories:		
Finished goods	422	358
Raw material	243	238
Work in process	93	91
	758	687
Total current assets	3,122	3,328
Property and equipment, net	1,049	1,027
Goodwill	841	839
Other intangible assets, net	155	160
Other assets	206	310
Total assets	$ 5,373	$ 5,664
LIABILITIES		
Current liabilities:		
Notes payable	$ 3	$ 1,004
Accounts payable	866	749
Accrued liabilities	642	650
Total current liabilities	1,511	2,403
Long-term debt	2,993	2,403
Other liabilities	766	800
Total liabilities	5,270	5,606
Commitments and contingencies (Note P)		
EQUITY		
Masco Corporation’s shareholders’ equity:		
Common shares, par value $1 per share		
Authorized shares: 1,400,000,000;	325	330
Issued and outstanding: 2016 – 324,500,000; 2015 – 330,500,000		
Preferred shares authorized: 1,000,000; Issued and outstanding: 2016 and 2015 – None	—	—
Paid-in capital	—	—
Retained deficit	(253)	(300)
Accumulated other comprehensive loss	(170)	(165)
Total Masco Corporation’s shareholders’ deficit	(98)	(135)

Noncontrolling interest	201	193
Total equity	103	58
Total liabilities and equity	$ 5,373	$ 5,664

See notes to condensed consolidated financial statements.

Table of Contents
MASCO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

For the Three and Nine Months Ended September 30, 2016 and 2015
(In Millions, Except Per Common Share Data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net sales	$1,877	$1,839	$5,598	$5,427
Cost of sales	1,263	1,250	3,715	3,706
Gross profit	614	589	1,883	1,721
Selling, general and administrative expenses	345	331	1,045	1,019
Operating profit	269	258	838	702
Other income (expense), net:				
Interest expense	(43)	(54)	(186)	(171)
Other, net	1	(6)	5	(2)
	(42)	(60)	(181)	(173)
Income from continuing operations before income taxes	227	198	657	529
Income tax expense	(81)	(77)	(229)	(219)
Income from continuing operations	146	121	428	310
Loss from discontinued operations, net	—	—	—	(1)
Net income	146	121	428	309
Less: Net income attributable to noncontrolling interest	12	10	35	29
Net income attributable to Masco Corporation	$134	$111	$393	$280
Income per common share attributable to Masco Corporation:				
Basic:				
Income from continuing operations	$.41	$.33	$1.18	$.81
Loss from discontinued operations, net	—	—	—	—
Net income	$.41	$.33	$1.18	$.81
Diluted:				
Income from continuing operations	$.40	$.32	$1.17	$.81
Loss from discontinued operations, net	—	—	—	—
Net income	$.40	$.32	$1.17	$.80
Amounts attributable to Masco Corporation:				
Income from continuing operations	$134	$111	$393	$281
Loss from discontinued operations, net	—	—	—	(1)
Net income	$134	$111	$393	$280

See notes to condensed consolidated financial statements.

Table of Contents
MASCO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (Unaudited)

For the Three and Nine Months Ended September 30, 2016 and 2015
(In Millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$146	$121	$428	$309
Less: Net income attributable to noncontrolling interest	12	10	35	29
Net income attributable to Masco Corporation	$134	$111	$393	$280
Other comprehensive income (loss), net of tax (Note K):				
Cumulative translation adjustment	$(1)	$(17)	$(10)	$(70)
Interest rate swaps	—	—	1	1
Pension and other post-retirement benefits	3	4	9	11
Realized gain on available-for-sale securities	—	—	(1)	—
Other comprehensive income (loss)	2	(13)	(1)	(58)
Less: Other comprehensive income (loss) attributable to noncontrolling interest	2	(1)	4	(10)
Other comprehensive income (loss) attributable to Masco Corporation	$—	$(12)	$(5)	$(48)
Total comprehensive income	$148	$108	$427	$251
Less: Total comprehensive income attributable to the noncontrolling interest	14	9	39	19
Total comprehensive income attributable to Masco Corporation	$134	$99	$388	$232

See notes to condensed consolidated financial statements.

Table of Contents
MASCO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For the Nine Months Ended September 30, 2016 and 2015
(In Millions)

	Nine Months Ended September 30, 2016	2015
CASH FLOWS FROM (FOR) OPERATING ACTIVITIES:		
Cash provided by operations	$569	$581
Increase in receivables	(245)	(245)
Increase in inventories	(73)	(41)
Increase in accounts payable and accrued liabilities, net	131	127
Net cash from operating activities	382	422
CASH FLOWS FROM (FOR) FINANCING ACTIVITIES:		
Retirement of notes	(1,300)	(500)
Purchase of Company common stock	(242)	(407)
Cash dividends paid	(95)	(94)
Dividend payment to noncontrolling interest	(31)	(36)
Cash distributed to TopBuild Corp.	—	(63)
Issuance of TopBuild Corp. debt	—	200
Issuance of notes, net of issuance costs	889	497
Issuance of Company common stock	1	2
Excess tax benefit from stock-based compensation	21	32
Decrease in debt, net	(2)	(1)
Credit Agreement and other financing costs	—	(3)
Net cash for financing activities	(759)	(373)
CASH FLOWS FROM (FOR) INVESTING ACTIVITIES:		
Capital expenditures	(117)	(112)
Acquisition of companies, net of cash acquired	—	(41)
Proceeds from disposition of:		
Short-term bank deposits	223	251
Other financial investments	14	7
Property and equipment	—	13
Purchases of:		
Short-term bank deposits	(151)	(225)
Other, net	(9)	(37)
Net cash for investing activities	(40)	(144)
Effect of exchange rate changes on cash and cash investments	(10)	(9)
CASH AND CASH INVESTMENTS:		
Decrease for the period	(427)	(104)
At January 1	1,468	1,383
At September 30	$1,041	$1,279

See notes to condensed consolidated financial statements.

Table of Contents
MASCO CORPORATION
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (Unaudited)

For the Nine Months Ended September 30, 2016 and 2015
(In Millions, Except Per Common Share Data)

	Total	Common Shares ($1 par value)	Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Loss	Noncontrolling Interest
Balance, January 1, 2015	$1,128	$ 345	$ —	$ 690	$ (111)	$ 204
Total comprehensive income (loss)	251			280	(48)	19
Shares issued	(9)	3	(12)			
Shares retired:						
Repurchased	(407)	(15)	(29)	(363)		
Surrendered (non-cash)	(18)	(1)		(17)		
Cash dividends declared	(94)			(94)		
Dividend payment to noncontrolling interest	(36)					(36)
Separation of TopBuild Corp.	(828)			(828)		
Stock-based compensation	41		41			
Balance, September 30, 2015	$28	$ 332	$ —	$ (332)	$ (159)	$ 187
Balance, January 1, 2016	$58	$ 330	$ —	$ (300)	$ (165)	$ 193
Total comprehensive income (loss)	427			393	(5)	39
Shares issued	(24)	3	(27)			
Shares retired:						
Repurchased	(252)	(8)	(8)	(236)		
Surrendered (non-cash)	(14)			(14)		
Cash dividends declared	(96)			(96)		
Dividend payment to noncontrolling interest	(31)					(31)
Stock-based compensation	35		35			
Balance, September 30, 2016	$103	$ 325	$ —	$ (253)	$ (170)	$ 201

See notes to condensed consolidated financial statements.

Table of Contents
MASCO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

A. ACCOUNTING POLICIES

In our opinion, the accompanying unaudited condensed consolidated financial statements contain all adjustments, of a normal recurring nature, necessary to present fairly our financial position as at September 30, 2016, and our results of operations and comprehensive income (loss) for the three-month and nine-month periods ended September 30, 2016 and 2015, and cash flows and changes in shareholders' equity for the nine-month periods ended September 30, 2016 and 2015. The condensed consolidated balance sheet at December 31, 2015 was derived from audited financial statements.

Reclassification. Certain prior year amounts have been reclassified to conform to the 2016 presentation in the condensed consolidated financial statements.

Revision of Previously Issued Financial Statements. We have revised the previously reported balances on our condensed consolidated balance sheet as of December 31, 2015 to correct the classification for warranty claims not expected to be settled within the next year. Accrued liabilities decreased and Other liabilities increased from the amounts previously reported by $102 million. This revision had no effect on our condensed consolidated statements of operations or condensed consolidated statements of cash flows. This revision is not considered material to our prior period financial statements.

Recently Issued Accounting Pronouncements. In February 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2015-02 ("ASU 2015-02") "Consolidation (Topic 810) — Amendments to the Consolidations Analysis," which modifies certain aspects of both the variable interest entities and voting interest entities models. We adopted ASU 2015-02 on January 1, 2016. The adoption of the new standard did not have an impact on our financial position or our results of operations.

In April 2015, the FASB issued Accounting Standards Update 2015 03 ("ASU 2015 03") "Interest - Imputation of Interest (Subtopic 835 30) - Simplifying the Presentation of Debt Issuance Costs," that requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt. In August 2015, the FASB issued ASU 2015-15 to clarify that debt issuance costs related to line of credit arrangements may remain classified as an asset. We retrospectively adopted both ASU 2015 03 and ASU 2015 15 on January 1, 2016. As a result of the retrospective adoption of the standards, we reclassified $15 million of debt issuance costs from Other assets to Long-term debt, and $1 million of debt issuance costs from Other assets to Notes payable, as of December 31, 2015.
In May 2014, the FASB issued a new standard for revenue recognition, Accounting Standards Codification 606 ("ASC 606"). The purpose of ASC 606 is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability across industries. ASC 606 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our results of operations.

In January 2016, the FASB issued Accounting Standards Update 2016-01 ("ASU 2016-01"), "Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities," which primarily affects the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. ASU 2016-01 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our financial position and results of operations.

In February 2016, the FASB issued a new standard for leases, Accounting Standards Codification 842 ("ASC 842"), which changes the accounting model for identifying and accounting for leases. ASC 842 is effective for us for annual periods beginning January 1, 2019. We are currently evaluating the impact the adoption of this new standard will have on our financial position and results of operations.

In March 2016, the FASB issued Accounting Standards Update 2016-09 ("ASU 2016-09"), "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting," which requires the tax effects related to share-based payments to be recorded through the income statement and simplifies the accounting requirements for forfeitures and employers' tax withholding requirements. ASU 2016-09 is effective for us for annual periods beginning January 1, 2017. We anticipate the impact of the adoption of this ASU to be limited to the reclassification of certain items within our statement of cash flows, which we intend to adopt retrospectively.

Table of Contents
MASCO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

A. ACCOUNTING POLICIES (Concluded)

In August 2016, the FASB issued Accounting Standards Update 2016-15 (“ASU 2016-15”), “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments,” which is intended to reduce diversity in practice as to how certain transactions are classified in the statement of cash flows. ASC 2016-15 is effective for us for annual periods beginning January 1, 2018. We are currently evaluating the impact the adoption of this new standard will have on our statement of cash flows.

B. DISCONTINUED OPERATIONS

The presentation of discontinued operations includes a component or group of components that we have or intend to dispose of, and represents a strategic shift that has (or will have) a major effect on our operations and financial results. For spin off transactions, discontinued operations treatment is appropriate following the completion of the spin off.

On September 30, 2014, we announced a plan to spin off 100 percent of our Installation and Other Services businesses into an independent, publicly-traded company named TopBuild Corp. (“TopBuild”) through a tax-free distribution of the stock of TopBuild to our stockholders. We initiated the spin off as TopBuild was no longer considered core to our long-term growth strategy in branded building products. We completed the spin off on June 30, 2015 at which time we accounted for it as a discontinued operation. Losses from this discontinued operation were included in loss from discontinued operations, net, in the condensed consolidated statement of operations for the three-month and nine-month periods ended September 30, 2015.

The major classes of line items constituting loss from discontinued operations, net, were as follows, in millions:

	Three Months Ended September 30, 2016	2015	Nine Months Ended September 30, 2016	2015
Net sales	$ —	$ —	$ —	$ 762
Cost of sales	—	—	—	603
Gross profit	—	—	—	159
Selling, general and administrative expenses	—	—	—	148
Income from discontinued operations	$ —	$ —	$ —	$ 11
Loss on disposal of discontinued operations, net	—	(1)	—	(1)
(Loss) income before income tax	—	(1)	—	10
Income tax benefit (expense) (A)	—	1	—	(11)
Loss from discontinued operations, net	$ —	$ —	$ —	$ (1)

(A) The unusual relationship between income tax expense and income before income tax for the nine-month period ended September 30, 2015 resulted primarily from certain non-deductible transaction costs related to the spin off of TopBuild.

Other selected financial information for TopBuild during the period owned by us was as follows, in millions:

	Nine Months Ended September 30,	
	2016	2015
Depreciation and amortization	$ —	$ 6
Capital expenditures	$ —	$ 7

In conjunction with the spin off, we entered into a Transition Services Agreement with TopBuild under which we provide administrative services to TopBuild subsequent to the separation. The fees for services rendered under the Transition Services Agreement are not material to our results of operations.

Table of Contents
MASCO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

C. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the nine-month period ended September 30, 2016, by segment, were as follows, in millions:

	Gross Goodwill At September 30, 2016	Accumulated Impairment Losses	Net Goodwill At September 30, 2016
Plumbing Products	$ 528	$ (340)	$ 188
Decorative Architectural Products	294	(75)	219
Cabinetry Products	240	(59)	181
Windows and Other Specialty Products	987	(734)	253
Total	$ 2,049	$ (1,208)	$ 841

	Gross Goodwill At December 31, 2015	Accumulated Impairment Losses	Net Goodwill At December 31, 2015	Other(A)	Net Goodwill At September 30, 2016
Plumbing Products	$ 525	$ (340)	$ 185	$ 3	$ 188
Decorative Architectural Products	294	(75)	219	—	219
Cabinetry Products	240	(59)	181	—	181
Windows and Other Specialty Products	988	(734)	254	(1)	253
Total	$ 2,047	$ (1,208)	$ 839	$ 2	$ 841

(A) Other principally includes the effect of foreign currency translation.

The carrying value of our other indefinite-lived intangible assets was $136 million and $137 million at September 30, 2016 and December 31, 2015, respectively, and principally included registered trademarks. The carrying value of our definite-lived intangible assets was $19 million (net of accumulated amortization of $17 million) and $23 million (net of accumulated amortization of $49 million) at September 30, 2016 and December 31, 2015, respectively, and principally included customer relationships.

D. DEPRECIATION AND AMORTIZATION

Depreciation and amortization expense, including discontinued operations, was $100 million for both of the nine-month periods ended September 30, 2016 and 2015.

E. FAIR VALUE OF FINANCIAL INVESTMENTS

We have maintained investments in available-for-sale securities, equity method investments and a number of private equity funds, principally as part of our tax planning strategies, as any gains enhance the utilization of any current and future tax capital losses. Financial investments were as follows, in millions:

	September 30, 2016	December 31, 2015
Prepaid expenses and other:		
Auction rate securities	$ 12	$ —

Other assets:		
Auction rate securities	—	22
Equity method investments	14	13
Private equity funds	7	10
Other investments	3	3
Total	$ 36	$ 48

E. FAIR VALUE OF FINANCIAL INVESTMENTS (Concluded)

Recurring Fair Value Measurements. Our auction rate securities are measured at fair value on a recurring basis, and have been estimated using a discounted cash flow model (Level 3 input). The significant inputs in the discounted cash flow model used to value the auction rate securities include: expected maturity of auction rate securities, discount rate used to determine the present value of expected cash flows and the assumptions for credit defaults, since the auction rate securities are backed by credit default swap agreements.

In the second quarter of 2016, $10 million of our auction rate securities were called by our counterparty and redeemed at a value that approximated our recorded basis. Our investments in auction rate securities had a recorded basis of $12 million and $22 million at September 30, 2016 and December 31, 2015, respectively, which included cost basis of $10 million and $19 million and pre-tax unrealized gains of $2 million and $3 million at each respective date.

Non-Recurring Fair Value Measurements. During the nine-month periods ended September 30, 2016 and 2015, we did not measure any financial investments at fair value on a non-recurring basis, as there was no other-than-temporary decline in the estimated value of these investments.

We did not have any transfers between Level 1 and Level 2 financial assets in the nine-month periods ended September 30, 2016 or 2015.

Realized Gains (Losses). Income from financial investments, net, included in other, net, within other income (expense), net, was as follows, in millions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Realized gains from auction rate securities	$ —	$ —	$ 1	$ —
Realized gains from private equity funds	1	1	2	5
Equity investment income, net	—	—	1	2
Total income from financial investments, net	$ 1	$ 1	$ 4	$ 7

Fair Value of Debt. The fair value of our short-term and long-term fixed-rate debt instruments is based principally upon modeled market prices for the same or similar issues or the current rates available to us for debt with similar terms and remaining maturities. The aggregate estimated market value of short-term and long-term debt at September 30, 2016 was approximately $3.3 billion, compared with the aggregate carrying value of $3.0 billion. The aggregate estimated market value of short-term and long-term debt at December 31, 2015 was approximately $3.6 billion, compared with the aggregate carrying value of $3.4 billion.

F. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

We are exposed to global market risk as part of our normal daily business activities. To manage these risks, we enter into various derivative contracts. These contracts include interest rate swap agreements, foreign currency contracts and metals contracts intended to hedge our exposure to copper and zinc. We review our hedging program, derivative positions and overall risk management on a regular basis.

Interest Rate Swap Agreements. In 2012, in connection with the issuance of $400 million of debt, we terminated the interest rate swap hedge relationships that we had entered into in 2011. These interest rate swaps were designated as cash flow hedges and effectively fixed interest rates on the forecasted debt issuance to variable rates based on 3-month LIBOR. Upon termination, the ineffective portion of the cash flow hedges of an approximate $2 million loss was recognized in our consolidated statement of operations in other, net within other income (expense), net. The remaining loss of approximately $23 million from the termination of these swaps is being amortized as an increase to interest expense over the remaining term of the debt, through March 2022.

Foreign Currency Contracts. Our net cash inflows and outflows exposed to the risk of changes in foreign currency exchange rates arise from the sale of products in countries other than the manufacturing source, foreign currency denominated supplier payments, debt and other payables, and investments in subsidiaries. To mitigate this risk, we, including certain of our European operations, entered into foreign currency forward contracts and foreign currency exchange contracts.

Table of Contents
MASCO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

F. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES (Concluded)

Gains (losses) related to foreign currency forward and exchange contracts are recorded in our condensed consolidated statements of operations in other, net, within other income (expense), net. In the event that the counterparties fail to meet the terms of the foreign currency forward or exchange contracts, our exposure is limited to the aggregate foreign currency rate differential with such institutions.

Metals Contracts. We have entered into several contracts to manage our exposure to increases in the price of copper and zinc. Gains (losses) related to these contracts are recorded in our condensed consolidated statements of operations in cost of sales.

The pre-tax gains (losses) included in our condensed consolidated statements of operations are as follows, in millions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Foreign currency contracts:				
Exchange contracts	$ —	$ —	$ —	$ 3
Forward contracts	—	1	—	(3)
Metals contracts	1	(9)	5	(14)
Interest rate swaps	—	—	(1)	(1)
Total gain (loss)	$ 1	$ (8)	$ 4	$ (15)

We present our derivatives net by counterparty, due to the right of offset under master netting arrangements, in the condensed consolidated balance sheets. The notional amounts being hedged and the fair value of those derivative instruments are as follows, in millions:

	At September 30, 2016	
	Notional Amount	Balance Sheet
Foreign currency contracts:		
Exchange contracts	$ 7	
Accrued liabilities		$ —
Forward contracts	28	
Accrued liabilities		(1)
Other liabilities		(1)
Metals contracts	13	
Accrued liabilities		—

	At December 31, 2015	
	Notional Amount	Balance Sheet

Foreign currency contracts:		
Exchange contracts	$ 39	
Receivables		$ 1
Forward contracts	30	
Accrued liabilities		(2)
Other liabilities		(1)
Metals contracts	50	
Accrued liabilities		(10)

The fair value of all foreign currency and metals derivative contracts is estimated on a recurring basis, quarterly, using Level 2 inputs (significant other observable inputs).

Table of Contents
MASCO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

G. WARRANTY LIABILITY

Changes in our warranty liability were as follows, in millions:

	Nine Months Ended September 30, 2016	Twelve Months Ended December 31, 2015
Balance at January 1	$ 152	$ 135
Accruals for warranties issued during the period	48	56
Accruals related to pre-existing warranties	36	15
Settlements made (in cash or kind) during the period	(43)	(50)
Other, net (including currency translation)	(1)	(4)
Balance at end of period	$ 192	$ 152

During 2016, a business in the Windows and Other Specialty Products segment recorded a $31 million increase as a change in estimate of expected future warranty claims resulting from recent warranty claim trends, including, among other items, the nature and type of claim and estimate of costs to service claims.

H. DEBT

On March 17, 2016, we issued $400 million of 3.5% Notes due April 1, 2021 and $500 million of 4.375% Notes due April 1, 2026. We received proceeds of $896 million, net of discount, for the issuance of these Notes. The Notes are senior indebtedness and are redeemable at our option at the applicable redemption price. On April 15, 2016, proceeds from the debt issuances, together with cash on hand, were used to repay and early retire all of our $1 billion, 6.125% Notes which were due on October 3, 2016 and all of our $300 million, 5.85% Notes which were due on March 15, 2017. In connection with these early retirements, we incurred $40 million of debt extinguishment costs, which we recorded as interest expense.
On March 28, 2013, we entered into a credit agreement (the “Credit Agreement”) with a bank group, with an aggregate commitment of $1.25 billion and a maturity date of March 28, 2018. On May 29, 2015 and August 28, 2015, we amended the Credit Agreement with the bank group (the “Amended Credit Agreement”). The Amended Credit Agreement reduced the aggregate commitment to $750 million and extends the maturity date to May 29, 2020. Under the Amended Credit Agreement, at our request and subject to certain conditions, we can increase the aggregate commitment up to an additional $375 million with the current bank group or new lenders.

The Amended Credit Agreement provides for an unsecured revolving credit facility available to us and one of our foreign subsidiaries, in U.S. dollars, European Euro and certain other currencies. Borrowings under the revolver denominated in euros are limited to $500 million, equivalent. We can also borrow swingline loans up to $75 million and obtain letters of credit of up to $100 million; any outstanding letters of credit under the Amended Credit Agreement reduce our borrowing capacity. At September 30, 2016, we had no outstanding standby letters of credit under the Amended Credit Agreement.

Revolving credit loans bear interest under the Amended Credit Agreement, at our option, at (A) a rate per annum equal to the greatest of (i) the prime rate, (ii) the Federal Funds effective rate plus 0.50% and (iii) LIBOR plus 1.0% (the “Alternative Base Rate”); plus an applicable margin based upon our then-applicable corporate credit ratings; or (B) LIBOR plus an applicable margin based upon our then-applicable corporate credit ratings. The foreign currency revolving credit loans bear interest at a rate equal to LIBOR plus an applicable margin based upon our then-applicable corporate credit ratings.

The Amended Credit Agreement contains financial covenants requiring us to maintain (A) a maximum net leverage ratio, as adjusted for certain items, of 4.0 to 1.0, and (B) a minimum interest coverage ratio, as adjusted for certain items, equal to or greater than 2.5 to 1.0.

Table of Contents

H. DEBT (Concluded)

In order for us to borrow under the Amended Credit Agreement, there must not be any default in our covenants in the Amended Credit Agreement (i.e., in addition to the two financial covenants, principally limitations on subsidiary debt, negative pledge restrictions, legal compliance requirements and maintenance of properties and insurance) and our representations and warranties in the Amended Credit Agreement must be true in all material respects on the date of borrowing (i.e., principally no material adverse change or litigation likely to result in a material adverse change, since December 31, 2014, in each case, no material ERISA or environmental non-compliance, and no material tax deficiency). We were in compliance with all covenants and had no borrowing under the Amended Credit Agreement at September 30, 2016.

I. STOCK-BASED COMPENSATION

Our 2014 Long Term Stock Incentive Plan (the "2014 Plan") provides for the issuance of stock-based incentives in various forms to our employees and non-employee Directors. At September 30, 2016, outstanding stock-based incentives were in the form of long-term stock awards, stock options, phantom stock awards and stock appreciation rights. Pre-tax compensation expense and the related income tax benefit for these stock-based incentives were as follows, in millions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Long-term stock awards	$ 5	$ 6	$ 17	$ 19
Stock options	1	1	2	5
Phantom stock awards and stock appreciation rights	4	—	6	6
Total	$ 10	$ 7	$ 25	$ 30
Income tax benefit (37 percent				