

Fortune Brands Home & Security, Inc.
Form 10-Q
October 31, 2017

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, 2017

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)

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

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

62-1411546
(I.R.S. Employer

Identification No.)

60015-5611
(Zip 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. 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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company and emerging growth 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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 October 20, 2017 was 151,800,773.

PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS.**FORTUNE BRANDS HOME & SECURITY, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Nine and Three Months Ended September 30, 2017 and 2016**

(In millions, except per share amounts)

(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2017	2016	2017	2016
Net sales	\$ 3,900.8	\$ 3,683.3	\$ 1,348.6	\$ 1,279.0
Cost of products sold	2,461.3	2,352.8	841.6	801.0
Selling, general and administrative expenses	877.7	831.4	297.3	284.5
Amortization of intangible assets	23.6	20.4	7.5	7.3
Loss on sale of product line (see Note 4)	2.4			
Asset impairment charges	3.2			
Restructuring charges	3.5	12.4	0.4	3.1
Operating income	529.1	466.3	201.8	183.1
Interest expense	36.5	37.5	12.3	11.8
Other expense (income), net	0.2	(0.1)	0.1	0.6
Income before income taxes	492.4	428.9	189.4	170.7
Income taxes	145.1	120.9	59.8	48.8
Income from continuing operations, net of tax	347.3	308.0	129.6	121.9
(Loss) income from discontinued operations, net of tax	(2.6)	1.5		1.5
Net income	344.7	309.5	129.6	123.4
Less: Noncontrolling interests	0.1	(0.1)	0.1	
Net income attributable to Fortune Brands	\$ 344.6	\$ 309.6	\$ 129.5	\$ 123.4
Basic earnings per common share				
Continuing operations	\$ 2.26	\$ 2.00	\$ 0.84	\$ 0.79
Discontinued operations	(0.02)	0.01		0.01
Net income attributable to Fortune Brands common shareholders	\$ 2.24	\$ 2.01	\$ 0.84	\$ 0.80

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Diluted earnings per common share

Continuing operations	\$ 2.22	\$ 1.95	\$ 0.83	\$ 0.77
Discontinued operations	(0.02)	0.01		0.01

Net income attributable to Fortune Brands common shareholders	\$ 2.20	\$ 1.96	\$ 0.83	\$ 0.78
Comprehensive income	\$ 391.1	\$ 309.8	\$ 158.7	\$ 110.5

See notes to condensed consolidated financial statements.

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

(In millions)

(Unaudited)

	September 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	\$ 277.1	\$ 251.5
Accounts receivable, net	594.7	550.7
Inventories	600.1	531.1
Other current assets	126.4	111.9
Total current assets	1,598.3	1,445.2
Property, plant and equipment, net of accumulated depreciation	690.6	662.5
Goodwill	1,852.8	1,833.8
Other intangible assets, net of accumulated amortization	1,105.4	1,107.0
Other assets	102.2	80.0
Total assets	\$ 5,349.3	\$ 5,128.5
Liabilities and equity		
Current liabilities		
Accounts payable	\$ 392.5	\$ 393.8
Other current liabilities	460.0	449.0
Total current liabilities	852.5	842.8
Long-term debt	1,462.2	1,431.1
Deferred income taxes	176.2	163.5
Accrued defined benefit plans	185.1	216.2
Other non-current liabilities	127.4	111.9
Total liabilities	2,803.4	2,765.5
Commitments and contingencies (see Note 17)		
Equity		
Fortune Brands stockholders' equity		
Common stock ^(a)	1.7	1.7
Paid-in capital	2,712.2	2,653.8
Accumulated other comprehensive loss	(25.5)	(71.9)
Retained earnings	1,076.5	814.6
Treasury stock	(1,220.6)	(1,036.7)
Total Fortune Brands stockholders' equity	2,544.3	2,361.5

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Noncontrolling interests	1.6	1.5
Total equity	2,545.9	2,363.0
Total liabilities and equity	\$ 5,349.3	\$ 5,128.5

^(a) *Common stock, par value \$0.01 per share: 179.6 million shares and 177.7 million shares issued at September 30, 2017 and December 31, 2016, respectively.*

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Nine Months Ended September 30, 2017 and 2016**

(In millions)

(Unaudited)

	2017	2016
Operating activities		
Net income	\$ 344.7	\$ 309.5
Non-cash pre-tax expense (income):		
Depreciation	72.7	69.3
Amortization	23.6	20.4
Stock-based compensation	32.7	24.3
Recognition of actuarial (gains) losses	(1.3)	1.9
Deferred income taxes	8.2	(23.0)
Loss on sale of product line	2.4	
Asset impairment charges	3.2	
Amortization of deferred financing costs	1.5	3.0
Loss on sale of property, plant and equipment	0.3	1.2
Changes in assets and liabilities:		
Increase in accounts receivable	(34.5)	(53.1)
(Increase) decrease in inventories	(60.7)	22.6
(Decrease) increase in accounts payable	(3.5)	28.7
Increase in other assets	(28.0)	(11.6)
Decrease in accrued expenses and other liabilities	(23.9)	(12.0)
Increase (decrease) in accrued taxes	15.2	(0.6)
Net cash provided by operating activities	352.6	380.6
Investing activities		
Capital expenditures ^(a)	(95.5)	(106.1)
Proceeds from the sale of assets	0.2	2.3
Proceeds from sale of product line	1.5	
Cost of acquisitions, net of cash acquired	(19.4)	(230.5)
Net cash used in investing activities	(113.2)	(334.3)
Financing activities		
Decrease in short-term debt, net		(1.0)
Issuance of long-term debt	375.0	880.0
Repayment of long-term debt	(345.0)	(465.0)
Proceeds from the exercise of stock options	25.8	24.8
Treasury stock purchases	(173.7)	(362.7)
Employee withholding taxes paid related to stock-based compensation	(10.2)	(9.8)

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Deferred acquisition payment	(12.4)	
Dividends to stockholders	(82.7)	(73.7)
Other financing, net	(0.3)	(2.1)
Net cash used in financing activities	(223.5)	(9.5)
Effect of foreign exchange rate changes on cash	9.7	3.3
Net increase in cash and cash equivalents	\$ 25.6	\$ 40.1
Cash and cash equivalents at beginning of period	\$ 251.5	\$ 238.5
Cash and cash equivalents at end of period	\$ 277.1	\$ 278.6

(a) *Capital expenditures of \$11.3 million and \$4.7 million that have not been paid as of September 30, 2017 and 2016, respectively, were excluded from the Statements of Cash Flows.*

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.**CONDENSED CONSOLIDATED STATEMENTS OF EQUITY****For the Nine Months Ended September 30, 2017 and 2016**

(In millions)

(Unaudited)

	Common Stock	Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Non- controlling Interests	Total Equity
Balance at December 31, 2015	\$ 1.7	\$ 2,602.2	\$ (52.5)	\$ 501.6	\$ (602.1)	\$ 2.9	\$ 2,453.8
Comprehensive income:							
Net income				309.6		(0.1)	309.5
Other comprehensive income			0.3				0.3
Stock options exercised		24.8					24.8
Stock-based compensation		24.3			(9.8)		14.5
Treasury stock purchase					(362.7)		(362.7)
Dividends (\$0.28 per common share)				(72.8)			(72.8)
Dividends paid to noncontrolling interests						(1.4)	(1.4)
Other		(5.8)					(5.8)
Balance at September 30, 2016	\$ 1.7	\$ 2,645.5	\$ (52.2)	\$ 738.4	\$ (974.6)	\$ 1.4	\$ 2,360.2
Balance at December 31, 2016	\$ 1.7	\$ 2,653.8	\$ (71.9)	\$ 814.6	\$ (1,036.7)	\$ 1.5	\$ 2,363.0
Comprehensive income:							
Net income				344.6		0.1	344.7
Other comprehensive income			46.4				46.4
Stock options exercised		25.7					25.7
Stock-based compensation		32.7			(10.2)		22.5
Treasury stock purchase					(173.7)		(173.7)
Dividends (\$0.54 per common share)				(82.7)			(82.7)
Balance at September 30, 2017	\$ 1.7	\$ 2,712.2	\$ (25.5)	\$ 1,076.5	\$ (1,220.6)	\$ 1.6	\$ 2,545.9

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 Fortune Brands, the Company, we, our and us refer to Fortune Brands Home & Security, Inc. and 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 and security applications.

The condensed consolidated balance sheet as of September 30, 2017, the related condensed consolidated statements of comprehensive income for the nine and three-month periods ended September 30, 2017 and 2016 and the related condensed consolidated statements of cash flows and equity for the nine-month periods ended September 30, 2017 and 2016 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 December 31, 2016 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, 2016.

In July 2017, we acquired Shaws Since1897 Limited (Shaws), a UK-based luxury plumbing products company that specializes in manufacturing and selling fireclay sinks and selling brassware and accessories in partnership with Perrin & Rowe. This acquisition broadened our plumbing portfolio and enhanced future growth opportunities. Net sales and operating income in the three months ended September 30, 2017 were not material to the Company. The financial results of Shaws were included in the Company's consolidated balance sheets as of September 30, 2017, the Company's consolidated statements of income for the nine and three months ended September 30, 2017, and statement of cash flows for the nine months ended September 30, 2017.

In September 2016, we acquired ROHL LLC (ROHL) and in a related transaction, we acquired TCL Manufacturing which gave us ownership of Perrin & Rowe Limited (Perrin & Rowe). In addition, in May 2016, we acquired Riobel Inc (Riobel). The financial results of ROHL, Perrin & Rowe, and Riobel were included in the Company's consolidated balance sheets as of September 30, 2017 and December 31, 2016, the Company's consolidated statements of income for the nine and three months ended September 30, 2017, and statement of cash flows for the nine months ended September 30, 2017.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, which clarifies the accounting for revenue arising from contracts with customers and specifies the disclosures that an entity should include in its financial statements. The standard is effective for annual reporting periods beginning after December 15, 2017 (calendar year 2018 for Fortune Brands). During 2016, the FASB issued certain amendments to the standard relating to the principal versus agent guidance, accounting for licenses of intellectual property and identifying performance obligations as well as the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. The effective date and transition requirements for these amendments are the same as those of the original ASU. We have elected the modified retrospective transition approach and also have identified focus areas for each of our reporting segments and have made substantial progress in our assessment of the accounting and financial reporting implications as of September 30, 2017. Our key considerations pursuant to ASU 2014-09 are the control of goods (i.e., timing of revenue recognition), separate performance obligations, customer rights of return (i.e., the reclassification on the balance sheet of the customer rights of return from accounts receivable to a refund liability as well as the recognition of a corresponding asset) and our accounting for display assets. We do not expect the change in accounting related to these considerations to have a material effect on our financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, which requires lessees to recognize almost all leases on their balance sheet as a right-of-use asset and lease liability but recognize related expenses in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions for all entities. The standard is effective for annual periods beginning after December 15, 2018 (calendar year 2019 for Fortune Brands) and earlier application is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued ASU 2017-12, that amends current hedge accounting model. The new standard eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item (consistent with our current practice). The change in fair value for qualifying cash flow and net investment hedges will be included in Other comprehensive income (until they are reclassified into the income statement). The standard also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of the hedge effectiveness. Standard is effective as of January 1, 2019 and earlier application is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards (Continued)

Clarifying Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets

In May 2017, the FASB issued ASC 610-20 that clarifies the scope and application of various standards for the sale of nonfinancial assets (e.g. PP&E including real estate, intangible assets, materials and supplies). The standard distinguishes between a sale to customer vs non-customer. Sales to customers are in scope of the new revenue standard. It also clarifies a derecognition model for nonfinancial assets that do not represent a business. The standard is effective as of January 1, 2018 consistent with the effective date for the new revenue recognition standard. We are assessing the impact the adoption of this standard will have on our financial statements and we will consider the implications of the new standard on case by case basis for all non-recurring transactions where we sell or transfer nonfinancial assets.

Stock Compensation Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09, which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance provides a relief to entities that make non-substantive changes to their share-based payment awards and will result in fewer changes to the terms of an award being accounted for as modifications. The standard is effective January 1, 2018 and early adoption is permitted; however we have elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

Presentation of Net Periodic Pension and Postretirement Cost

In March 2017, the FASB issued ASU 2017-07, which requires entities to present the service cost component of the net periodic benefit cost in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components (i.e., interest cost, expected return on plan assets and actuarial gains/losses) separately from the line item(s) that includes the service cost and outside of any subtotal of operating income. The standard is effective January 1, 2018 and early adoption is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, which simplifies the accounting for goodwill impairment for all entities. Under the new standard, if a reporting unit's carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. The standard eliminates the current requirement to calculate a goodwill impairment charge by comparing the implied fair value of goodwill with its carrying amount (i.e., hypothetical purchase price allocation). The new standard is effective for annual and interim impairment tests performed in the periods beginning after January 1, 2020 and early adoption is permitted. We plan to early adopt ASU 2017-04 in conjunction with our annual goodwill impairment test during the fourth quarter of 2017.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards (Continued)

Clarifying the Definition of a Business

In January 2017, the FASB issued ASU 2017-01, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business and therefore business combination guidance would apply. The new standard requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset (i.e., a business) or a group of similar identifiable assets (i.e., not a business). The guidance also requires a business to include at least one substantive process and narrows the definition of outputs (e.g., revenues with customers). The standard is effective January 1, 2018 and early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our financial statements.

Restricted Cash

In November 2016, the FASB issued ASU 2016-18, according to which entities are no longer required to present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. The prior standard did not address the classification of activity related to restricted cash and restricted cash equivalents in the statement of cash flows, which has resulted in diversity in the presentation of cash flows. The standard is effective January 1, 2018 and early adoption is permitted; however, we elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued ASU 2016-16, which requires companies to account for the income tax effects of intercompany sales and transfers of assets other than inventory (e.g., intangible assets) when the transfer occurs. Under the current guidance, companies are required to defer the income tax effects of intercompany transfers of assets until the asset has been sold to an outside party or otherwise recognized (e.g., depreciated, amortized or impaired). The standard is effective January 1, 2018 and early adoption is permitted; however, we elected not to early adopt. The transition method will be a modified retrospective (i.e., with a cumulative adjustment to retained earnings at adoption). We are assessing the impact the adoption of this standard will have on our financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Recently Issued Accounting Standards (Continued)

Classification of Certain Cash Receipts and Cash Payments

In September 2016, the FASB issued ASU 2016-15, which changes how an entity classifies certain cash receipts and cash payments on its statement of cash flows. The key changes that may potentially impact our financial statements include the following: 1) Cash payments for debt prepayment or extinguishment costs would be classified as financing cash outflows; 2) Contingent consideration payments that are not made within three months after the consummation of a business combination would be classified as financing (if the payment is made up to the acquisition date fair value of liability) or operating outflows (if in excess of acquisition fair value). Cash payments made soon after the consummation of a business combination generally would be classified as cash outflows for investing activities; 3) Insurance settlement proceeds would be classified based on the nature of the loss; and 4) Company-owned life insurance settlement proceeds would be presented as investing cash inflows, and premiums would be classified as investing or operating cash outflows, or a combination of both. The new standard is effective January 1, 2018 and should be adopted retrospectively. Early adoption is permitted; however, we elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

Financial Instruments Credit Losses

In June 2016, the FASB issued ASU 2016-13, which changes the impairment model for most financial assets and certain other instruments that are not measured at fair value through net income. The new guidance applies to most financial assets measured at amortized cost, including trade and other receivables and loans as well as off-balance-sheet credit exposures (e.g., loan commitments and standby letters of credit). The standard will replace the incurred loss approach under the current guidance with an expected loss model that requires an entity to estimate its lifetime expected credit loss. The standard is effective January 1, 2020 and early application is permitted beginning January 1, 2019. We are assessing the impact the adoption of this standard will have on our financial statements.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, which requires entities to measure investments in unconsolidated entities (other than those accounted for using the equity method of accounting) at fair value through the income statement. There will no longer be an available-for-sale classification (with changes in fair value reported in Other Comprehensive Income). In addition, the cost method is eliminated for equity investments without readily determinable fair values. The new standard is effective January 1, 2018. Early application is permitted for certain provisions of the standard; however, we elected not to early adopt. 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)	September 30, 2017	December 31, 2016
Inventories:		
Raw materials and supplies	\$ 211.6	\$ 207.6
Work in process	61.8	55.9
Finished products	326.7	267.6
Total inventories	\$ 600.1	\$ 531.1
Property, plant and equipment, gross	\$ 1,715.8	\$ 1,630.7
Less: accumulated depreciation	1,025.2	968.2
Property, plant and equipment, net	\$ 690.6	\$ 662.5

4. Acquisitions and Dispositions

In July 2017, we acquired Shaws, a UK-based luxury plumbing products company that specializes in manufacturing and selling fireclay sinks and selling brassware and accessories in partnership with Perrin & Rowe. Net sales and operating income in the three months ended September 30, 2017 were not material to the Company. We financed the transaction using cash on hand and borrowings under our existing credit facilities. The results of the operations are included in the Plumbing segment from the date of acquisition.

In April 2017, we completed the sale of Field ID, our cloud-based inspection and safety compliance software product line included in our Security segment. We recorded a pre-tax loss of \$2.4 million as the result of this sale. The estimated tax expense on the sale was insignificant. Field ID did not qualify for presentation as a discontinued operation in our financial statements.

In September 2016, we acquired ROHL, a California-based luxury plumbing company. In a related transaction, we also acquired Perrin & Rowe, a UK manufacturer and designer of luxury kitchen and bathroom plumbing products. The total combined purchase price was approximately \$166 million (including \$3 million of liabilities assumed), subject to certain post-closing adjustments. We financed the transaction using cash on hand and borrowings under our existing credit facility. Net sales and operating income in the first nine months of 2017 were not material to the Company. The results of operations are included in the Plumbing segment. The goodwill expected to be deductible for income tax purposes is approximately \$49 million.

In May 2016, we acquired Riobel, a Canadian plumbing company specializing in premium showroom bath and shower fittings, for a total purchase price of \$94.6 million in cash. We financed the transaction using cash on hand and borrowings under our existing credit facilities. Net sales and operating income in the first nine months of 2017 were not material to the Company. The results of operations are included in the Plumbing segment. We do not expect any portion of goodwill to be deductible for income tax purposes.

We recognized a loss on discontinued operations primarily related to the prior sale of the Waterloo tool storage and Simonton window businesses for the nine months ended September 30, 2017.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Goodwill and Identifiable Intangible Assets

We had goodwill of \$1,852.8 million and \$1,833.8 million as of September 30, 2017 and December 31, 2016, respectively. The \$19.0 million increase was primarily due to the acquisition-related adjustments in our Plumbing segment (See Note 4) and foreign translation adjustments. The change in the net carrying amount of goodwill by segment was as follows:

(In millions)	Cabinets	Plumbing	Doors	Security	Total Goodwill
Goodwill at December 31, 2016 ^(a)	\$ 924.3	\$ 670.2	\$ 143.0	\$ 96.3	\$ 1,833.8
Year-to-date translation adjustments	3.3	4.6		1.5	9.4
Acquisition-related adjustments		9.6			9.6
Goodwill at September 30, 2017 ^(a)	\$ 927.6	\$ 684.4	\$ 143.0	\$ 97.8	\$ 1,852.8

^(a) Net of accumulated impairment losses of \$399.5 million in the Doors segment.

We also had net identifiable intangible assets, principally tradenames, of \$1,105.4 million and \$1,107.0 million as of September 30, 2017 and December 31, 2016, respectively.

The gross carrying value and accumulated amortization by class of identifiable intangible assets as of September 30, 2017 and December 31, 2016 were as follows:

(In millions)	As of September 30, 2017			As of December 31, 2016		
	Gross Carrying Amounts	Accumulated Amortization	Net Book Value	Gross Carrying Amounts	Accumulated Amortization	Net Book Value
Indefinite-lived tradenames	\$ 682.6	\$	\$ 682.6	\$ 671.8	\$	\$ 671.8
Amortizable intangible assets						
Tradenames	18.6	(9.4)	9.2	15.8	(7.3)	8.5
Customer and contractual relationships	627.1	(226.0)	401.1	611.9	(203.1)	408.8
Patents/proprietary technology	57.2	(44.7)	12.5	61.9	(44.0)	17.9
Total	702.9	(280.1)	422.8	689.6	(254.4)	435.2
Total identifiable intangibles	\$ 1,385.5	\$ (280.1)	\$ 1,105.4	\$ 1,361.4	\$ (254.4)	\$ 1,107.0

The \$24.1 million increase in gross identifiable intangible assets was primarily due to acquisition-related adjustments in our Plumbing segment (See Note 4) as well as foreign translation adjustments, partially offset by impairment charges during the first quarter of 2017 related to our decision to sell Field ID (See Note 6).

Amortizable identifiable intangible assets, principally tradenames and customer relationships, are subject to amortization on a straight-line basis over their estimated useful life, ranging from 2 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, customer attrition rates and other relevant factors.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Goodwill and Identifiable Intangible Assets (Continued)

As of December 31, 2016, the fair value of one of the tradenames in the Cabinets segment and one of the tradenames in the Doors segment exceeded their carrying value by less than 10%. In the second quarter of 2017, we performed an interim impairment test on the tradename in the Cabinets segment and concluded the fair value continues to exceed its carrying value. A further reduction in fair value of these tradenames may result in an impairment charge in future periods. As of September 30, 2017, the carrying values of these tradenames was \$168 million. We did not identify any impairment triggers during the third quarter of 2017. In addition to evaluating the interim events that may require more frequent impairment testing, we will conduct our annual impairment testing in the fourth quarter of 2017.

The Company cannot predict the occurrence of certain events that might adversely affect the carrying value of goodwill and other intangible assets. 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, lower levels of discretionary consumer spending, a decrease in royalty rates and decline in the trading price of our common stock. We cannot predict the occurrence of certain events or changes in circumstances that might adversely affect the carrying value of goodwill and indefinite-lived intangible assets.

6. Asset Impairment

In January 2017, we committed to a plan to sell Field ID, our cloud-based inspection and safety compliance software product line included in our Security segment. In accordance with FASB Accounting Standards Codification (ASC) 360, as a result of our decision to sell, during the first quarter of 2017 we recorded \$3.2 million of pre-tax impairment charges to write down the long-lived assets included in this disposal group to fair value, based upon their estimated fair value less cost to sell. These charges consisted of approximately \$3.0 million for definite-lived intangible assets and \$0.2 million for fixed assets. We completed the sale of Field ID in April 2017 (See Note 4).

7. External Debt and Financing Arrangements

In June 2016, the Company amended and restated its credit agreement to combine and rollover the existing revolving credit facility and term loan into a new standalone \$1.25 billion revolving credit facility. This amendment of the credit agreement was a non-cash transaction for the Company. Terms and conditions of the amended and restated credit agreement, including the total commitment amount, essentially remained the same. As a result of the refinancing, we wrote-off prepaid debt issuance costs of approximately \$1.3 million during the three months ended June 30, 2016. The revolving credit facility will mature in June 2021 and borrowings thereunder will be used for general corporate purposes. On September 30, 2017 and December 31, 2016, our outstanding borrowings under this facility were \$570.0 million and \$540.0 million, respectively. At September 30, 2017 and December 31, 2016, the current portion of long-term debt was zero. Interest rates under the facility are variable based on LIBOR at the time of the borrowing and the Company's long-term credit rating and can range from LIBOR + 0.9% to LIBOR + 1.5%. As of September 30, 2017, we were in compliance with all covenants under this facility.

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**7. External Debt and Financing Arrangements (Continued)**

In June 2015, we issued \$900 million of unsecured senior notes (Senior Notes) in a registered public offering. The Senior Notes consist of two tranches: \$400 million of five-year notes due 2020 with a coupon of 3% and \$500 million of ten-year notes due 2025 with a coupon of 4%. We used the proceeds from the Senior Notes offering to pay down our revolving credit facility and for general corporate purposes. On September 30, 2017 and December 31, 2016, the carrying value of the Senior Notes, net of underwriting commissions, price discounts and debt issuance costs, was \$892.2 million and \$891.1 million, respectively.

We currently have uncommitted bank lines of credit in China, which provide for unsecured borrowings for working capital of up to \$25.7 million in aggregate, of which there were no outstanding balances as of September 30, 2017 and December 31, 2016.

8. 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. Raw materials used by the Company are subject to price volatility caused by weather, supply conditions, geopolitical and economic variables, and other unpredictable external factors. As a result, from time to time, we enter into commodity swaps to manage the price risk associated with forecasted purchases of materials used in our operations.

Our primary foreign currency hedge contracts pertain to the Canadian dollar, the Mexican peso, the Chinese yuan and the Euro. The gross U.S. dollar equivalent notional amount of all foreign currency derivative hedges outstanding at September 30, 2017 was \$190.2 million, representing a net settlement payable of \$2.3 million. Based on foreign exchange rates as of September 30, 2017, we estimate that \$1.2 million of net foreign currency derivative losses included in other comprehensive income as of September 30, 2017 will be reclassified to earnings within the next twelve months.

The fair values of derivative instruments on the consolidated balance sheets as of September 30, 2017 and December 31, 2016 were as follows:

(In millions)	Location	Fair Value	
		September 30, 2017	December 31, 2016
<u>Assets</u>			
Foreign exchange contracts	Other current assets	\$ 3.0	\$ 2.8

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Net investment hedges	Other current assets	0.2		0.6
	Total assets	\$ 3.2	\$	3.4
<u>Liabilities</u>				
Foreign exchange contracts	Other current liabilities	\$ 5.1	\$	2.9
Net investment hedges	Other current liabilities	0.4		0.2
	Total current liabilities	\$ 5.5	\$	3.1

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Financial Instruments (Continued)

The effects of derivative financial instruments on the statements of comprehensive income for the nine and three months ended September 30, 2017 and 2016 were:

(In millions)		Gain (Loss) Recognized in Income Nine Months Ended September 30,	
Type of hedge	Location	2017	2016
Cash flow	Cost of products sold	\$ 0.9	\$ (2.6)
Fair value	Other (income) expense, net	(1.4)	1.3
Total		\$ (0.5)	\$ (1.3)

(In millions)		Gain (Loss) Recognized in Income Three Months Ended September 30,	
Type of hedge	Location	2017	2016
Cash flow	Cost of products sold	\$ (0.1)	\$ (1.2)
Fair value	Other (income) expense, net	(0.9)	0.3
Total		\$ (1.0)	\$ (0.9)

The effective portion of cash flow hedges recognized in other comprehensive income were net losses of \$(0.1) million and \$(8.0) million in the nine months ended September 30, 2017 and 2016, respectively. The effective portion of cash flow hedges recognized in other comprehensive income were net losses of \$(3.8) million and zero in the three months ended September 30, 2017 and 2016, respectively. In the nine and three months ended September 30, 2017 and 2016, the ineffective portion of cash flow hedges recognized in other (income) expense, net, was insignificant.

9. Fair Value Measurements

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.

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**9. Fair Value Measurements (Continued)**

The carrying value, net of underwriting commissions, price discounts, and debt issuance costs and fair value of debt as of September 30, 2017 and December 31, 2016 were as follows:

(In millions)	September 30, 2017		December 31, 2016	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Revolving credit facility	\$ 570.0	\$ 570.0	\$ 540.0	\$ 540.0
Senior Notes	892.2	927.5	891.1	919.2

The estimated fair value of our revolving credit facility is determined primarily using broker quotes, which are level 2 inputs. The estimated fair value of our Senior Notes is determined by using quoted market prices of our debt securities, which are level 1 inputs.

Assets and liabilities measured at fair value on a recurring basis as of September 30, 2017 and December 31, 2016 were as follows:

(In millions)	Fair Value	
	September 30, 2017	December 31, 2016
Assets		
Derivative financial instruments (level 2)	\$ 3.2	\$ 3.4
Deferred compensation program assets (level 2)	7.0	4.5
Total assets	\$ 10.2	\$ 7.9
Liabilities		
Derivative financial instruments (level 2)	\$ 5.5	\$ 3.1

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**10. Accumulated Other Comprehensive Loss**

Total accumulated other comprehensive loss 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 loss, net of tax, were as follows:

(In millions)	Foreign Currency Adjustments	Derivative Hedging Gain (Loss)	Defined Benefit Plan Adjustments ^(a)	Accumulated Other Comprehensive Loss
Balance at December 31, 2015	\$ (13.3)	\$ 2.1	\$ (41.3)	\$ (52.5)
Amounts classified into accumulated other comprehensive loss	0.9	(7.3)	9.0	2.6
Amounts reclassified from accumulated other comprehensive loss		2.8	(5.1)	(2.3)
Net current-period other comprehensive income (loss)	0.9	(4.5)	3.9	0.3
Balance at September 30, 2016	\$ (12.4)	\$ (2.4)	\$ (37.4)	\$ (52.2)
Balance at December 31, 2016	\$ (28.0)	\$ (0.6)	\$ (43.3)	\$ (71.9)
Amounts classified into accumulated other comprehensive loss	47.0	0.6	3.5	51.1
Amounts reclassified from accumulated other comprehensive loss		(0.6)	(4.1)	(4.7)
Net current-period other comprehensive income (loss)	47.0		(0.6)	46.4
Balance at September 30, 2017	\$ 19.0	\$ (0.6)	\$ (43.9)	\$ (25.5)

^(a) See Note 11, *Defined Benefit Plans*, for further information on the adjustments related to defined benefit plans.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Accumulated Other Comprehensive Loss (Continued)

The reclassifications out of accumulated other comprehensive loss for the nine and three months ended September 30, 2017 and 2016 were as follows:

(In millions)

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Statement of Comprehensive Income
	Nine Months Ended September 30, 2017	Three Months Ended September 30, 2016	
<u>(Losses) gains on cash flow hedges</u>			
Foreign exchange contracts	\$ 0.5	\$ (2.5)	Cost of products sold
Commodity contracts	0.4	(0.1)	Cost of products sold
	0.9	(2.6)	Total before tax
	(0.3)	(0.2)	Tax expense
	\$ 0.6	\$ (2.8)	Net of tax
<u>Defined benefit plan items</u>			
Recognition of prior service credits	\$ 5.1	\$ 10.0	(a)
Recognition of actuarial gains (losses)	1.3	(1.9)	(a)
	6.4	8.1	Total before tax
	(2.3)	(3.0)	Tax expense
	\$ 4.1	\$ 5.1	Net of tax
Total reclassifications for the period	\$ 4.7	\$ 2.3	Net of tax

(In millions)

Details about Accumulated Other Comprehensive Loss Components	Amount Reclassified from Accumulated Other Comprehensive Loss		Affected Line Item in the Statement of Comprehensive Income
	Three Months Ended September 30, 2017	Three Months Ended September 30, 2016	
<u>Gains (losses) on cash flow hedges</u>			
Foreign exchange contracts	\$ (0.5)	\$ (1.3)	Cost of products sold

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Commodity contracts	0.4	0.1	Cost of products sold
	(0.1)	(1.2)	Total before tax
	0.2		Tax expense
	\$ 0.1	\$ (1.2)	Net of tax
<u>Defined benefit plan items</u>			
Recognition of prior service credits	\$	\$ 3.8	(a)
Recognition of actuarial gains (losses)	1.3	(1.0)	(a)
	1.3	2.8	Total before tax
	(0.4)	(1.0)	Tax expense
	\$ 0.9	\$ 1.8	Net of tax
Total reclassifications for the period	\$ 1.0	\$ 0.6	Net of tax

(a) These accumulated other comprehensive loss components are included in the computation of net periodic benefit cost. Refer to Note 11, Defined Benefit Plans, for additional information.

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**11. Defined Benefit Plans**

The components of net periodic benefit cost for pension and postretirement benefits for the nine and three months ended September 30, 2017 and 2016 were as follows:

(In millions)	Nine Months Ended September 30,			
	Pension Benefits		Postretirement Benefits	
	2017	2016	2017	2016
Service cost	\$ 0.4	\$ 7.2	\$	\$
Interest cost	25.0	25.8		0.2
Expected return on plan assets	(28.0)	(27.9)		
Recognition of prior service costs (credits)			(5.1)	(10.0)
Recognition of actuarial losses (gains)	0.3		(1.6)	1.9
Net periodic benefit (income) cost	\$ (2.3)	\$ 5.1	\$ (6.7)	\$ (7.9)

(In millions)	Three Months Ended September 30,			
	Pension Benefits		Postretirement Benefits	
	2017	2016	2017	2016
Service cost	\$0.1	\$1.6	\$	\$
Interest cost	8.3	8.4		(0.1)
Expected return on plan assets	(9.3)	(8.9)		
Recognition of prior service costs (credits)				(3.8)
Recognition of actuarial losses (gains)	0.3		(1.6)	1.0
Net periodic benefit (income) cost	\$ (0.6)	\$ 1.1	\$ (1.6)	\$ (2.9)

Service cost for 2017 relates to benefit accruals in an hourly Union defined benefit plan in our Security segment. All other defined benefit pension plans were frozen as of December 31, 2016.

FORTUNE BRANDS HOME & SECURITY, INC.**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. Income Taxes**

The effective income tax rates for the nine months ended September 30, 2017 and 2016 were 29.5% and 28.2%, respectively. The increase in the effective tax rate reflected a lower tax benefit on share-based compensation, partially offset by a valuation allowance release related to state deferred tax assets. In addition, the effective tax rates in both periods were favorably impacted by a tax benefit attributable to the Domestic Production Activity (Internal Revenue Code Section 199) Deduction, favorable tax rates in foreign jurisdictions, and a benefit associated with the U.S. research and development credit, offset by state and local taxes and increases to uncertain tax positions.

The effective income tax rates for the three months ended September 30, 2017 and 2016 were 31.6% and 28.6%, respectively. The increase in the effective tax rate reflected a lower tax benefit on share-based compensation, partially offset by a valuation allowance release related to state deferred tax assets. In addition, the effective tax rates in both periods were favorably impacted by a tax benefit attributable to the Domestic Production Activity (Internal Revenue Code Section 199) Deduction, favorable tax rates in foreign jurisdictions, and a benefit associated with the U.S. research and development credit, offset by state and local taxes and increases to uncertain tax positions.

It is reasonably possible that, within the next 12 months, total unrecognized tax benefits may decrease up to \$1.5 million, primarily as a result of the conclusion of pending U.S. federal, state and foreign income tax proceedings.

13. 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 historical claims experience and the nature of the product category. The following table summarizes activity related to our product warranty liability for the nine months ended September 30, 2017 and 2016, respectively.

(In millions)	Nine Months Ended	
	September 30, 2017	2016
Reserve balance at January 1,	\$ 16.2	\$ 16.0
Provision for warranties issued	23.3	23.8
Settlements made (in cash or in kind)	(17.0)	(22.8)
Foreign translation adjustments	(1.2)	
Acquisitions	0.7	0.4
Reserve balance at September 30,	\$ 22.0	\$ 17.4

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**14. Information on Business Segments**

Net sales and operating income for the nine and three months ended September 30, 2017 and 2016 by segment were as follows:

(In millions)	Nine Months Ended September 30,		
	2017	2016	% Change vs. Prior Year
<u>Net Sales</u>			
Cabinets	\$ 1,841.2	\$ 1,797.2	2.4%
Plumbing	1,251.5	1,108.0	13.0
Doors	374.2	351.3	6.5
Security	433.9	426.8	1.7
Net sales	\$ 3,900.8	\$ 3,683.3	5.9%
<u>Operating Income</u>			
Cabinets	\$ 205.4	\$ 194.0	5.9%
Plumbing	270.8	242.6	11.6
Doors	55.8	46.1	21.0
Security	56.4	44.7	26.2
Less: Corporate expenses	(59.3)	(61.1)	2.9
Operating income	\$ 529.1	\$ 466.3	13.5%
<u>Corporate expenses</u>			
General and administrative expense	\$ (63.8)	\$ (61.3)	
Defined benefit plan income	3.2	2.1	
Recognition of defined benefit plan actuarial gains (losses)	1.3	(1.9)	
Total Corporate expenses	\$ (59.3)	\$ (61.1)	2.9%

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**14. Information on Business Segments (Continued)**

(In millions)	Three Months Ended September 30,		
	2017	2016	% Change vs. Prior Year
<u>Net Sales</u>			
Cabinets	\$ 614.2	\$ 602.1	2.0%
Plumbing	438.3	391.1	12.1
Doors	138.5	129.2	7.2
Security	157.6	156.6	0.6
Net sales	\$ 1,348.6	\$ 1,279.0	5.4%
<u>Operating Income</u>			
Cabinets	\$ 69.7	\$ 74.8	(6.8)%
Plumbing	97.3	84.0	15.8
Doors	25.1	22.3	12.6
Security	27.7	22.9	21.0
Less: Corporate expenses	(18.0)	(20.9)	13.9
Operating income	\$ 201.8	\$ 183.1	10.2%
<u>Corporate expenses</u>			
General and administrative expense	\$ (20.5)	\$ (20.5)	
Defined benefit plan income	1.2	0.6	
Recognition of defined benefit plan actuarial gains (losses)	1.3	(1.0)	
Total Corporate expenses	\$ (18.0)	\$ (20.9)	13.9%

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Restructuring and Other Charges

Pre-tax restructuring and other charges for the nine and three months ended September 30, 2017 and 2016 are shown below.

(In millions)	Nine Months Ended September 30, 2017		
	Restructuring Charges	Other Charges ^(a)	Total Charges
Plumbing	1.6	\$	\$ 1.6
Security	1.9	0.9	2.8
Total	\$ 3.5	\$ 0.9	\$ 4.4

^(a) *Other Charges* represent charges directly related to restructuring initiatives that cannot be reported as restructuring under 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 nine months of 2017 largely related to severance costs within our Security and Plumbing segments.

(In millions)	Nine Months Ended September 30, 2016		
	Restructuring Charges	Other Charges ^(a)	Total Charges
Cabinets	\$ 1.8	\$	\$ 1.8
Plumbing	1.1	0.8	1.9
Security	9.5	3.5	13.0
Total	\$ 12.4	\$ 4.3	\$ 16.7

^{a)} *Other Charges* represent charges directly related to restructuring initiatives that cannot be reported as restructuring under 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 nine months of 2016 primarily related to severance costs and charges associated with the relocation of a manufacturing facility within our Security segment.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Restructuring and Other Charges (Continued)

(In millions)	Three Months Ended September 30, 2017		
	Restructuring Charges	Other Charges ^(a)	Total Charges
Doors	\$ 0.2	\$ (0.1)	\$ 0.1
Security	0.2	0.3	0.5
Total	\$ 0.4	\$ 0.2	\$ 0.6

^(a) *Other Charges* represent charges directly related to restructuring initiatives that cannot be reported as restructuring under 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 third quarter of 2017 primarily resulted from severance costs within our Doors and Plumbing Segments.

(In millions)	Three Months Ended September 30, 2016		
	Restructuring Charges	Other Charges ^(a)	Total Charges
Plumbing	\$ 0.4	\$ 0.5	\$ 0.9
Security	2.7	1.0	3.7
Total	\$ 3.1	\$ 1.5	\$ 4.6

^(a) *Other Charges* represent charges directly related to restructuring initiatives that cannot be reported as restructuring under 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 third quarter of 2016 primarily resulted from severance costs within our Security segment.

FORTUNE BRANDS HOME & SECURITY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**15. Restructuring and Other Charges (Continued)****Reconciliation of Restructuring Liability**

<i>(In millions)</i>	Balance at 12/31/16	2017 Provision	Cash Expenditures ^(a)	Non-Cash Write-offs	Balance at 9/30/17
Workforce reduction costs	\$ 2.4	\$ 2.8	\$ (2.9)	\$ (0.5)	\$ 1.8
Other	0.6	0.7	(1.3)		0.0
	\$ 3.0	\$ 3.5	\$ (4.2)	\$ (0.5)	\$ 1.8

^(a) Cash expenditures primarily related to severance charges.

<i>(In millions)</i>	Balance at 12/31/15	2016 Provision	Cash Expenditures ^(a)	Non-Cash Write-offs ^(b)	Balance at 9/30/16
Workforce reduction costs	\$ 10.4	\$ 8.7	\$ (15.0)	\$ 0.2	\$ 4.3
Other	0.5	3.7	(3.0)	(0.6)	0.6
	\$ 10.9	\$ 12.4	\$ (18.0)	\$ (0.4)	\$ 4.9

^(a) Cash expenditures primarily related to severance charges.

^(b) Non-cash write-offs include asset impairment charges attributable to restructuring actions.

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. Earnings Per Share

The computations of earnings per common share were as follows:

(In millions, except per share data)	Nine Months Ended September 30,		Three Months Ended September 30,	
	2017	2016	2017	2016
Income from continuing operations, net of tax	\$ 347.3	\$ 308.0	\$ 129.6	\$ 121.9
Less: Noncontrolling interest	0.1	(0.1)	0.1	
Income from continuing operations for EPS	347.2	308.1	129.5	121.9
Income from discontinued operations	(2.6)	1.5		1.5
Net income attributable to Fortune Brands	\$ 344.6	\$ 309.6	\$ 129.5	\$ 123.4
Earnings per common share				
Basic				
Continuing operations	\$ 2.26	\$ 2.00	\$ 0.84	\$ 0.79
Discontinued operations	(0.02)	0.01		0.01
Net income attributable to Fortune Brands common stockholders	\$ 2.24	\$ 2.01	\$ 0.84	\$ 0.80
Diluted				
Continuing operations	\$ 2.22	\$ 1.95	\$ 0.83	\$ 0.77
Discontinued operations	(0.02)	0.01		0.01
Net income attributable to Fortune Brands common stockholders	\$ 2.20	\$ 1.96	\$ 0.83	\$ 0.78
Basic average shares outstanding	153.7	154.4	153.5	154.2
Stock-based awards	2.5	3.6	2.4	3.4
Diluted average shares outstanding	156.2	158.1	155.9	157.6
Antidilutive stock-based awards excluded from weighted-average number of shares outstanding for diluted earnings per share	0.6	0.5	0.6	

FORTUNE BRANDS HOME & SECURITY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)

17. 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 Fortune Brands during the nine months ended September 30, 2017 and 2016. 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. We believe, 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. Uncertainties about the status of laws, regulations, technology and information related to individual sites make it difficult to develop estimates of environmental remediation exposures.

18. Subsequent Event

In October 2017, the Company acquired Victoria + Albert, a UK manufacturer of luxury freestanding tubs and basins. Victoria + Albert represent a strong strategic fit, adding a preeminent luxury tub brand to our plumbing portfolio. The results of operations of the acquired company will be included in the Plumbing segment from the date of acquisition. This acquisition will not have a material effect on net sales or operating income.

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, 2016, which are included in our Annual Report on Form 10-K for the year ended December 31, 2016.

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, as amended (the Exchange Act), regarding business strategies, market potential, future financial performance, pension contributions, impact of acquisitions 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 conditional verbs such as will, should, would, may and could are generally forward-looking in nature and not historical facts. Where, in any forward-looking statement, we express an expectation or belief as to future results or events, such expectation or belief based on current 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. 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) 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 defined 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, 2016. 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 Fortune Brands, the Company, we, our and us refer to Fortune Brands Home & Security, Inc. and 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, entry door systems and security products.

We believe the Company has certain competitive advantages including market-leading brands, a diversified mix of channels, lean and flexible supply chains, a decentralized business model and a strong capital structure 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 grow, we expect the benefits of operating leverage and strategic spending to support increased manufacturing capacity and long-term growth initiatives will help us continue to achieve profitable organic growth.

OVERVIEW (Continued)

We believe our most attractive opportunities are to invest in profitable organic growth initiatives. We also believe that as the market grows, we have the potential to generate additional growth from leveraging our cash flow and balance sheet by pursuing accretive strategic acquisitions and joint ventures, and by returning cash to shareholders through a combination of dividends and common stock 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 midst of an elongated recovery from the U.S. economic recession that ended in mid-2009 and that a continued recovery will largely depend on consumer confidence, employment, home prices, stable mortgage rates 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 an 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, changes in foreign exchange and promotional activity among our competitors. We strive to offset the potential unfavorable impact of these items with productivity improvement initiatives and price increases.

In July 2017, we acquired Shaws Since 1897 Limited (Shaws), a UK-based luxury plumbing products company that specializes in manufacturing and selling fireclay sinks and selling brassware and accessories in partnership with Perrin & Rowe. We financed the transaction using cash on hand and borrowings under our existing credit facilities. This acquisition broadened our plumbing portfolio and enhanced future growth opportunities. Net sales and operating income in the three months ended September 30, 2017 were not material to the Company. The results of the operations are included in the Plumbing segment.

During the third quarter of 2016, we created the Global Plumbing Group (GPG), which was designed to support the growth of multiple plumbing brands with an enhanced set of products and brands, while leveraging Moen's existing global supply chain and broad distribution network.

In September 2016, we acquired ROHL LLC (ROHL), a California-based luxury plumbing company and in a related transaction, we acquired TCL Manufacturing Ltd, which gave us ownership of Perrin & Rowe Limited, a UK manufacturer and designer of luxury kitchen and bathroom plumbing products. The total combined purchase price was approximately \$166 million, subject to certain post-closing adjustments. We financed both acquisitions using cash on hand and borrowings under our existing credit facility. These transactions broadened the plumbing portfolio and enhanced future growth opportunities.

In June 2016, we amended and restated our credit agreement to combine and rollover our existing revolving credit facility and term loan into a new standalone \$1.25 billion revolving credit facility. Terms and conditions of the credit agreement, including the total commitment amount, essentially remained the same. The revolving credit facility will mature in June 2021 and borrowings thereunder will be used for general corporate purposes.

In May 2016, we acquired Riobel Inc. (Riobel), a Canadian plumbing company specializing in premium showroom bath and shower fittings, for a total purchase price of \$94.6 million in cash. We financed the transaction using cash on hand and borrowings under our existing credit facility.

Nine Months Ended September 30, 2017 Compared To Nine Months Ended September 30, 2016

(In millions)	Net Sales		
	2017	2016	% Change vs. Prior Year
Cabinets	\$ 1,841.2	\$ 1,797.2	2.4%
Plumbing	1,251.5	1,108.0	13.0
Doors	374.2	351.3	6.5
Security	433.9	426.8	1.7
Net sales	\$ 3,900.8	\$ 3,683.3	5.9%

	Operating Income		
	2017	2016	% Change vs. Prior Year
Cabinets	\$ 205.4	\$ 194.0	5.9%
Plumbing	270.8	242.6	11.6
Doors	55.8	46.1	21.0
Security	56.4	44.7	26.2
Less: Corporate expenses	(59.3)	(61.1)	2.9
Operating income	\$ 529.1	\$ 466.3	13.5%

The following discussion of consolidated results of operations and segment results refers to the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. Consolidated results of operations should be read in conjunction with segment results of operations.

Net sales

Net sales increased \$217.5 million, or 5.9%. The increase was due to higher sales volume primarily from the continuing improvement in U.S. market conditions for home products, new product introductions, the benefits from the acquisitions in our Plumbing segment and price increases to help mitigate cumulative raw material cost increases. These benefits were partially offset by unfavorable mix, higher sales promotions, sales rebates and unfavorable foreign exchange of approximately \$4 million.

Cost of products sold

Cost of products sold increased \$108.5 million, or 4.6%, due to higher net sales, including the impact of the acquisitions in our Plumbing segment and raw material cost increases, partially offset by the benefit of productivity improvements.

Selling, general and administrative expenses

Selling, general and administrative expenses increased \$46.3 million, or 5.6%, due to higher employee-related costs and advertising costs as well as the impact of the acquisitions in our Plumbing segment.

RESULTS OF OPERATIONS (Continued)

Amortization of intangible assets

Amortization of intangible assets increased \$3.2 million primarily due to the acquisitions in our Plumbing segment, partially offset by a decrease relating to a definite-lived customer relationship intangible in our Doors segment that was fully amortized during the second quarter of 2017.

Loss on sale of product line

In April 2017, we completed the sale of Field ID, our cloud-based inspection and safety compliance software product line included in our Security segment. We recorded a pre-tax loss of \$2.4 million as the result of this sale.

Asset impairment charges

Asset impairment charges of \$3.2 million relate to our decision in the first quarter of 2017 to sell Field ID, our cloud-based inspection and safety compliance software product line included in our Security segment.

Restructuring charges

Restructuring charges of \$3.5 million in the nine months ended September 30, 2017 primarily relates to severance costs within our Security and Plumbing segments. Restructuring charges in the nine months ended September 30, 2016 were \$12.4 million and primarily related to severance costs and charges associated with supply chain initiatives within our Security segment.

Operating income

Operating income increased \$62.8 million, or 13.5%, primarily due to higher net sales, including the benefits from the acquisitions in our Plumbing segment and productivity improvements. These benefits were partially offset by unfavorable mix, higher employee-related, raw material and advertising costs.

Interest expense

Interest expense decreased \$1.0 million to \$36.5 million primarily due to the absence in 2017 of the write-off of debt issuance costs of approximately \$1.3 million incurred during 2016.

Other (income) expense, net

Other (income) expense, net, was expense of \$0.2 million in the nine months ended September 30, 2017, compared to income of \$0.1 million in the nine months ended September 30, 2016.

Income taxes

The effective income tax rates for the nine months ended September 30, 2017 and 2016 were 29.5% and 28.2%, respectively. The increase in the effective tax rate reflected a lower tax benefit on share-based compensation, partially offset by a valuation allowance release related to state deferred tax assets. In addition, the effective tax rates in both periods were favorably impacted by a tax benefit attributable to the Domestic Production Activity (Internal Revenue Code Section 199) Deduction, favorable tax rates in foreign jurisdictions, and a benefit associated with the U.S.

research and development credit, offset by state and local taxes and increases to uncertain tax positions.

Net income from continuing operations

Net income from continuing operations was \$347.3 million in the nine months ended September 30, 2017 compared to \$308.0 million in the nine months ended September 30, 2016. The increase of \$39.3 million was primarily due to higher operating income.

RESULTS OF OPERATIONS (Continued)

Loss from discontinued operations

The loss from discontinued operations of \$2.6 million in the nine months ended September 30, 2017 primarily related to the prior sale of the Waterloo tool storage and Simonton window businesses. The income from discontinued operations of \$1.5 million in the nine months ended September 30, 2016 included the effect of tax adjustments relating to the Waterloo business.

Results by Segment

Cabinets

Net sales increased \$44.0 million, or 2.4%, due to higher sales volume driven primarily by continuing improvement in the U.S. home products market and the benefit from new product introductions and price increases to help mitigate cumulative raw material cost increases. These benefits were partially offset by unfavorable mix and higher sales promotions.

Operating income increased \$11.4 million, or 5.9%, due to the increase in net sales and productivity improvements. These benefits were partially offset by unfavorable mix and higher employee-related costs.

Plumbing

Net sales increased \$143.5 million, or 13.0%, due to higher sales volume driven by continuing improvement in the U.S. home products market and the benefit from new product introductions, higher sales in international markets, principally China, and the benefit from the acquisitions of Riobel, ROHL and Perrin & Rowe in 2016 as well as Shaws in 2017. These benefits were partially offset by higher sales rebates and unfavorable foreign exchange of approximately \$4 million.

Operating income increased \$28.2 million, or 11.6%, due to higher net sales, productivity improvements and favorable mix. These benefits were partially offset by higher employee-related costs, raw material costs and advertising costs.

Doors

Net sales increased \$22.9 million, or 6.5%, due to higher sales volume driven primarily by continuing improvement in the U.S. home products market and the benefit from new product introductions and price increases to help mitigate cumulative raw material cost increases.

Operating income increased \$9.7 million, or 21.0%, due to the higher net sales and leveraging sales on our existing fixed cost base.

RESULTS OF OPERATIONS (Continued)**Results by Segment (Continued)****Security**

Net sales increased \$7.1 million, or 1.7%, due to higher sales volume and price increases to help mitigate cumulative raw material cost increases. These benefits were partially offset by unfavorable foreign exchange of approximately \$1 million and by the impact of our exiting of two product lines in our commercial distribution channel.

Operating income increased \$11.7 million, or 26.2%, primarily due to productivity improvements, lower restructuring and other charges (approximately \$10 million) relating to the completion in 2016 of a manufacturing facility relocation and the related cost savings resulting from the facility relocation, as well as higher net sales. These benefits were partially offset by higher raw material costs.

Corporate

Corporate expenses decreased by \$1.8 million predominantly due to recognition of an actuarial gain versus an actuarial loss in the prior year and higher defined benefit plan income during 2017 in comparison to prior year.

(In millions)	Nine Months Ended	
	September 30,	
	2017	2016
General and administrative expense	\$ (63.8)	\$ (61.3)
Defined benefit plan income	3.2	2.1
Defined benefit plan recognition of actuarial gain/(loss)	1.3	(1.9)
Total Corporate expenses	\$ (59.3)	\$ (61.1)

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.

RESULTS OF OPERATIONS (Continued)**Three Months Ended September 30, 2017 Compared To Three Months Ended September 30, 2016**

(In millions)	Net Sales		
	2017	2016	% Change vs. Prior Year
Cabinets	\$ 614.2	\$ 602.1	2.0%
Plumbing	438.3	391.1	12.1
Doors	138.5	129.2	7.2
Security	157.6	156.6	0.6
Net sales	\$ 1,348.6	\$ 1,279.0	5.4%

	Operating Income		
	2017	2016	% Change vs. Prior Year
Cabinets	\$ 69.7	\$ 74.8	(6.8)%
Plumbing	97.3	84.0	15.8
Doors	25.1	22.3	12.6
Security	27.7	22.9	21.0
Less: Corporate expenses	(18.0)	(20.9)	13.9
Operating income	\$ 201.8	\$ 183.1	10.2%

The following discussion of consolidated results of operations and segment results refers to the three months ended September 30, 2017 compared to the three months ended September 30, 2016. Consolidated results of operations should be read in conjunction with segment results of operations.

Net sales

Net sales increased \$69.6 million, or 5.4%. The increase was due to higher sales volume primarily from the continuing improvement in U.S. market conditions for home products, new product introductions, the benefits from the acquisitions in our Plumbing segment, price increases to help mitigate cumulative raw material cost increases and favorable foreign exchange of approximately \$4 million. These benefits were partially offset by unfavorable mix, higher sales rebates and sales promotions.

Cost of products sold

Cost of products sold increased \$40.6 million, or 5.1%, due to higher net sales, including the impact of acquisitions in our Plumbing segment and higher raw material costs, partially offset by the benefit of productivity improvements.

Selling, general and administrative expenses

Selling, general and administrative expenses increased \$12.8 million, or 4.5%, due to higher employee-related costs, including higher healthcare costs, as well as the impact of the acquisitions in our Plumbing segment.

RESULTS OF OPERATIONS (Continued)

Amortization of intangible assets

Amortization of intangible assets increased \$0.2 million due to the acquisitions in our Plumbing segment, partially offset by a decrease relating to a definite-lived customer relationship intangible in Doors segment that was fully amortized during the second quarter of 2017.

Restructuring charges

Restructuring charges in the three months ended September 30, 2017 and 2016 were \$0.4 million and \$3.1 million, respectively. Restructuring charges in 2017 relate to severance costs within our Security and Doors segments. Restructuring charges in 2016 primarily relate to supply chain initiatives within our Security segment.

Operating income

Operating income increased \$18.7 million, or 10.2%, primarily due to higher net sales and productivity improvements. These benefits were partially offset by unfavorable mix and higher employee-related costs.

Interest expense

Interest expense increased \$0.5 million to \$12.3 million primarily due to higher average interest rates partially offset by lower average borrowings.

Other (income) expense, net

Other (income) expense, net, was expense of \$0.1 million in the three months ended September 30, 2017 compared to expense of \$0.6 million in the three months ended September 30, 2016.

Income taxes

The effective income tax rates for the three months ended September 30, 2017 and 2016 were 31.6% and 28.6%, respectively. The increase in the effective tax rate reflected a lower tax benefit on share-based compensation, partially offset by a valuation allowance release related to state deferred tax assets. In addition, the effective tax rates in both periods were favorably impacted by a tax benefit attributable to the Domestic Production Activity (Internal Revenue Code Section 199) Deduction, favorable tax rates in foreign jurisdictions, and a benefit associated with the U.S. research and development credit, offset by state and local taxes and increases to uncertain tax positions.

Net income from continuing operations

Net income from continuing operations was \$129.6 million in the three months ended September 30, 2017 compared to \$121.9 million in the three months ended September 30, 2016. The increase of \$7.7 million was primarily due to a higher operating income.

RESULTS OF OPERATIONS (Continued)

Results by Segment

Cabinets

Net sales increased \$12.1 million, or 2.0%, due to higher sales volume driven primarily by continuing improvement in the U.S. home products market and the benefit from new product introductions, price increases to help mitigate cumulative raw material cost increases and favorable foreign exchange of approximately \$2 million. These benefits were partly offset by unfavorable mix and higher sales promotions.

Operating income decreased \$5.1 million, or 6.8%, due to higher employee-related costs, including higher healthcare costs. These benefits were partially offset by the increase in net sales and productivity improvements.

Plumbing

Net sales increased \$47.2 million, or 12.1%, due to higher sales volume in the U.S. driven by continuing improvement in the U.S. home products market and the benefit from new product introductions, higher sales in international markets, principally China and Canada, the benefit from the acquisitions of ROHL and Perrin & Rowe in 2016 as well as Shaws in 2017 and favorable foreign exchange of approximately \$2 million. These benefits were partially offset by higher sales rebates.

Operating income increased \$13.3 million, or 15.8%, due to higher net sales and productivity improvements partially offset by higher employee-related costs, sales rebates and raw material costs.

Doors

Net sales increased \$9.3 million, or 7.2%, due to favorable mix, higher sales volume driven primarily by improved conditions in the U.S. home products markets and the benefit from new product introductions and price increases to help mitigate cumulative raw material cost increases.

Operating income increased \$2.8 million, or 12.6%, due to higher net sales and leveraging sales on our existing fixed cost base.

Security

Net sales increased \$1.0 million, or 0.6%, due to higher sales volume in the U.S. and international markets for our core locks and safes product lines and favorable foreign exchange offset by the impact from our exiting of two product lines in our commercial sales distribution channel.

Operating income increased \$4.8 million, or 21.0%, primarily due to productivity improvements, lower restructuring and other charges (approximately \$3 million) relating to the completion in 2016 of a manufacturing facility relocation and the related cost savings resulting from the facility relocation.

RESULTS OF OPERATIONS (Continued)**Results by Segment (Continued)****Corporate**

Corporate expenses decreased by \$2.9 million predominantly due to recognition of an actuarial gain versus an actuarial loss in the prior quarter and higher defined benefit plan income during 2017 in comparison to prior quarter.

(In millions)	Three Months Ended	
	September 30,	
	2017	2016
General and administrative expense	\$ (20.5)	\$ (20.5)
Defined benefit plan income	1.2	0.6
Defined benefit plan recognition of actuarial gains (losses)	1.3	(1.0)
Total Corporate expenses	\$ (18.0)	\$ (20.9)

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 Fortune Brands. In December 2016, our Board of Directors increased the quarterly cash dividend by 13% to \$0.18 per share of our outstanding common stock. Our Board of Directors will continue to evaluate dividend payment opportunities on a quarterly basis. There can be no assurance as to when and if future dividends will be paid, and at what level, because the payment of dividends is dependent on our financial condition, results of operations, cash flows, capital requirements and other factors deemed relevant by our Board of Directors.

In the first nine months of 2017, we repurchased 2.8 million shares of our outstanding common stock under the Company's share repurchase programs for \$173.7 million. As of September 30, 2017, the Company's total remaining share repurchase authorization under the repurchase programs was approximately \$347 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.

We periodically review our portfolio of brands and evaluate potential strategic transactions and other capital initiatives 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, 2016 entitled "Item 1A. Risk Factors."

Acquisitions in 2017 and 2016 included:

In October 2017, the Company acquired Victoria + Albert, a UK manufacturer of luxury freestanding tubs and basins. The results of operations of the acquired company will be included in the Plumbing segment from the date of acquisition. This acquisition will not have a material effect on net sales or operating income.

In July 2017, we acquired Shaws Since 1897 Limited, a U.K.-based company that specializes in the design, production and marketing of luxury fire-clay kitchen sinks. We financed the transaction using cash on hand and borrowings under our existing credit facilities. Net sales and operating income in the three months ended September 30, 2017 were not material to the Company.

In September 2016, we acquired ROHL, a California-based luxury plumbing company and in a related transaction, we acquired TCL Manufacturing Ltd, which gave us ownership of Perrin & Rowe, a UK manufacturer and designer of luxury kitchen and bathroom plumbing products. The total combined purchase price was approximately \$166 million, subject to certain post-closing adjustments. We financed both acquisitions using cash on hand and borrowings under our existing credit facility.

In May 2016, we acquired Riobel, a Canadian plumbing company specializing in premium showroom bath and shower fittings, for a total purchase price of \$94.6 million in cash. We financed the transaction using cash on hand and borrowings under our existing credit facilities.

On September 30, 2017, we had cash and cash equivalents of \$277.1 million, of which \$257.9 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 most of 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.

Cash Flows

Below is a summary of cash flows for the nine months ended September 30, 2017 and 2016.

(In millions)	Nine Months Ended September 30,	
	2017	2016
Net cash provided by operating activities	\$ 352.6	\$ 380.6
Net cash used in investing activities	(113.2)	(334.3)
Net cash used in financing activities	(223.5)	(9.5)
Effect of foreign exchange rate changes on cash	9.7	3.3
Net increase in cash and cash equivalents	\$ 25.6	\$ 40.1

Net cash provided by operating activities was \$352.6 million in the nine months ended September 30, 2017 compared to \$380.6 million in the nine months ended September 30, 2016. The decrease in cash provided of \$28.0 million was primarily due to a higher build in working capital during 2017 compared to 2016 which included inventory reductions as we completed our manufacturing facility relocations in our Plumbing and Security businesses, partly offset by higher net income.

Net cash used in investing activities was \$113.2 million in the nine months ended September 30, 2017 compared to \$334.3 million in the nine months ended September 30, 2016. The decrease of \$221.1 million was primarily due to the decrease in cost of acquisitions of \$211.1 million.

Net cash used by financing activities was \$223.5 million in the nine months ended September 30, 2017 compared to net cash used of \$9.5 million in the nine months ended September 30, 2016. The increase in cash used of \$214 million during 2017 was primarily due to lower net borrowings of \$384 million and higher dividends of \$9 million, partially offset by lower share repurchases in 2017 compared to 2016 (\$189 million decrease). Additionally, during the third quarter 2017, we paid deferred acquisition payments totaling \$12.4 million (net of certain working capital and other adjustments) relating to the ROHL and Perrin & Rowe acquisitions.

Pension Plans

Subsidiaries of Fortune Brands 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, 2016, the fair value of our total pension plan assets was \$577.7 million, representing 73% of the accumulated benefit obligation liability. In 2017, we expect to make total pension contributions of approximately \$25 million of which \$22 million has been paid as of September 30, 2017. 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 operations in various foreign countries, principally Canada, China, Mexico, the United Kingdom 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

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, which clarifies the accounting for revenue arising from contracts with customers and specifies the disclosures that an entity should include in its financial statements. The standard is effective for annual reporting periods beginning after December 15, 2017 (calendar year 2018 for Fortune Brands). During 2016, the FASB issued certain amendments to the standard relating to the principal versus agent guidance, accounting for licenses of intellectual property and identifying performance obligations as well as the guidance on transition, collectability, noncash consideration and the presentation of sales and other similar taxes. The effective date and transition requirements for these amendments are the same as those of the original ASU. We have elected the modified retrospective transition approach and also have identified focus areas for each of our reporting segments and have made substantial progress in our assessment of the accounting and financial reporting implications as of September 30, 2017. Our key considerations pursuant to ASU 2014-09 are the control of goods (i.e., timing of revenue recognition), separate performance obligations, customer rights of return (i.e., the reclassification on the balance sheet of the customer rights of return from accounts receivable to a refund liability as well as the recognition of a corresponding asset) and our accounting for display assets. We do not expect the change in accounting related to these considerations to have a material effect on our financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, which requires lessees to recognize almost all leases on their balance sheet as a right-of-use asset and lease liability but recognize related expenses in a manner similar to current accounting. The guidance also eliminates current real estate-specific provisions for all entities. The standard is effective for annual periods beginning after December 15, 2018 (calendar year 2019 for Fortune Brands) and earlier application is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

Improvements to Accounting for Hedging Activities

In August 2017, the FASB issued ASU 2017-12, that amends current hedge accounting model. The new standard eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item (consistent with our current practice). The change in fair value for qualifying cash flow and net investment hedges will be included in Other comprehensive income (until they are reclassified into the income statement). The standard also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. The standard is effective as of January 1, 2019 and earlier application is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

RECENTLY ISSUED ACCOUNTING STANDARDS (Continued)

Clarifying Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets

In May 2017, the FASB issued ASC 610-20 that clarifies the scope and application of various standards for the sale of nonfinancial assets (e.g. PP&E including real estate, intangible assets, materials and supplies). The standard distinguishes between a sale to customer vs non-customer. Sales to customers are in scope of the new revenue standard. It also clarifies a derecognition model for nonfinancial assets that do not represent a business. The standard is effective as of January 1, 2018 consistent with the effective date for the new revenue recognition standard. We are assessing the impact the adoption of this standard will have on our financial statements and we will consider the implications of the new standard on case by case basis for all non-recurring transactions where we sell or transfer nonfinancial assets.

Stock Compensation Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09, which clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The new guidance provides a relief to entities that make non-substantive changes to their share-based payment awards and will result in fewer changes to the terms of an award being accounted for as modifications. The standard is effective January 1, 2018 and early adoption is permitted, however we elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

Presentation of Net Periodic Pension and Postretirement Cost

In March 2017, the FASB issued ASU 2017-07, which requires entities to present the service cost component of the net periodic benefit cost in the same income statement line item(s) as other employee compensation costs arising from services rendered during the period. In addition, only the service cost component will be eligible for capitalization in assets. Employers will present the other components (i.e., interest cost, expected return on plan assets and actuarial gains/losses) separately from the line item(s) that includes the service cost and outside of any subtotal of operating income. The standard is effective January 1, 2018 and early adoption is permitted. We are assessing the impact the adoption of this standard will have on our financial statements.

Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, which simplifies the accounting for goodwill impairment for all entities. Under the new standard, if a reporting unit's carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. The standard eliminates the current requirement to calculate a goodwill impairment charge by comparing the implied fair value of goodwill with its carrying amount (i.e., hypothetical purchase price allocation). The standard is effective for annual and interim impairment tests performed in the periods beginning after January 1, 2020 and early adoption is permitted. We plan to early adopt ASU 2017-04 in conjunction with our annual goodwill impairment test during the fourth quarter of 2017.

RECENTLY ISSUED ACCOUNTING STANDARDS (Continued)

Clarifying the Definition of a Business

In January 2017, the FASB issued ASU 2017-01, which changes the definition of a business to assist entities with evaluating when a set of transferred assets and activities is a business and therefore business combination guidance would apply. The new standard requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset (i.e., a business) or a group of similar identifiable assets (i.e., not a business). The guidance also requires a business to include at least one substantive process and narrows the definition of outputs (e.g., revenues with customers). The standard is effective January 1, 2018 and early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our financial statements.

Restricted Cash

In November 2016, the FASB issued ASU 2016-18, according to which entities are no longer required to present transfers between cash and cash equivalents and restricted cash and restricted cash equivalents in the statement of cash flows. The prior standard did not address the classification of activity related to restricted cash and restricted cash equivalents in the statement of cash flows which has resulted in diversity in cash flows presentation. The standard is effective January 1, 2018 and early adoption is permitted; however, we elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued ASU 2016-16, which requires companies to account for the income tax effects of intercompany sales and transfers of assets other than inventory (e.g., intangible assets) when the transfer occurs. Under the current guidance companies are required to defer the income tax effects of intercompany transfers of assets until the asset has been sold to an outside party or otherwise recognized (e.g., depreciated, amortized or impaired). The standard is effective January 1, 2018 and early adoption is permitted; however, we elected not to early adopt. The transition method will be a modified retrospective (i.e., with a cumulative adjustment to retained earnings at adoption). We are assessing the impact the adoption of this standard will have on our financial statements.

Classification of Certain Cash Receipts and Cash Payments

In September 2016 the FASB issued ASU 2016-15, which changes how an entity classifies certain cash receipts and cash payments on its statement of cash flows. The key changes that may potentially impact our financial statements include the following: 1) Cash payments for debt prepayment or extinguishment costs would be classified as financing cash outflows; 2) Contingent consideration payments that are not made within three months after the consummation of a business combination would be classified as financing (if the payment is made up to the acquisition date fair value of liability) or operating outflows (if in excess of acquisition fair value). Cash payments made soon after the consummation of a business combination generally would be classified as cash outflows for investing activities; 3) Insurance settlement proceeds would be classified based on the nature of the loss; and 4) Company-owned life insurance settlement proceeds would be presented as investing cash inflows, and premiums would be classified as investing or operating cash outflows, or a combination of both. The new standard is effective January 1, 2018 and should be adopted retrospectively. Early adoption is permitted; however, we elected not to early adopt. We do not expect the adoption of this standard to have a material effect on our financial statements.

RECENTLY ISSUED ACCOUNTING STANDARDS (Continued)

Financial Instruments Credit Losses

In June 2016, the FASB issued ASU 2016-13, which changes the impairment model for most financial assets and certain other instruments that are not measured at fair value through net income. The new guidance applies to most financial assets measured at amortized cost, including trade and other receivables and loans as well as off-balance-sheet credit exposures (e.g., loan commitments and standby letters of credit). The standard will replace the incurred loss approach under the current guidance with an expected loss model that requires an entity to estimate its lifetime expected credit loss. The standard is effective January 1, 2020 and early application is permitted beginning January 1, 2019. We are assessing the impact the adoption of this standard will have on our financial statements.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, which requires entities to measure investments in unconsolidated entities (other than those accounted for using the equity method of accounting) at fair value through the income statement. There will no longer be an available-for-sale classification (with changes in fair value reported in Other Comprehensive Income). In addition, the cost method is eliminated for equity investments without readily determinable fair values. The standard is effective January 1, 2018. Early application is permitted for certain provisions of the standard; however, we elected not to early adopt. 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, 2016.

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 September 30, 2017 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.

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 Fortune Brands during the nine months ended September 30, 2017 and 2016. 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. We believe 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. Uncertainties about the status of laws, regulations, technology and information related to individual sites make it difficult to develop estimates of environmental remediation exposures.

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, 2016 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 September 30, 2017:

Issuer Purchases of Equity Securities

Period	Total number of shares purchased (a)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (a)	Maximum dollar amount that may yet be purchased under the plans or programs (a)
July 1 - July 31	603,750	\$ 66.18	603,750	\$ 450,381,443
August 1 - August 31	881,646	63.53	881,646	394,375,046
September 1 - September 30	729,023	64.51	729,023	347,346,977
Total	2,214,419	\$ 64.57	2,214,419	

(a) Information on the Company's share repurchase programs follows:

Authorization and announcement date	Announcement date	Authorization amount of shares of outstanding common stock	Expiration date
February 16, 2016	February 22, 2016	\$ 400 million	February 16, 2018
February 28, 2017	March 1, 2017	\$ 300 million	February 28, 2019

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 September 30, 2017 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: October 31, 2017

/s/ Patrick Hallinan

Patrick Hallinan

Senior Vice President and Chief Financial Officer

(Duly authorized officer and principal financial officer
of the Registrant)