FORTUNE BRANDS INC
Form 10-Q
August 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007

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 1-9076

FORTUNE BRANDS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**13-3295276**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

520 Lake Cook Road, Deerfield, Illinois 60015-5611
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: (847) 484-4400

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and larger accelerated filer in Rule 12b-2 of the Exchange Act. Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The number of shares outstanding of the registrant s common stock, par value $3.125 per share, at July 31, 2007 was 153,173,059.

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions)

	June 30, 2007 (Unaudited)	December 31, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 150.8	$ 182.7
Accounts receivable, net	1,316.2	1,165.3
Inventories		
Maturing spirits and wine	1,228.7	1,186.0
Other raw materials, supplies and work in process	437.3	452.4
Finished products	564.5	548.6
	2,230.5	2,187.0
Other current assets	444.7	395.1
Total current assets	4,142.2	3,930.1
Property, plant and equipment, net	1,949.1	1,948.5
Goodwill resulting from business acquisitions	4,350.9	4,345.6
Other intangible assets resulting from business acquisitions, net	4,109.9	4,096.9
Investments in unconsolidated subsidiaries	183.1	179.9
Other assets	273.0	167.3
Total assets	$ 15,008.2	$ 14,668.3

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEET

(in millions, except per share amounts)

	June 30, 2007 (Unaudited)	December 31, 2006
Liabilities and stockholders equity		
Current liabilities		
Notes payable to banks	$ 30.9	$ 25.6
Commercial paper	749.2	762.0
Current portion of long-term debt	200.1	1.7
Accounts payable	460.7	492.5
Accrued taxes	287.6	251.0
Accrued customer programs	112.1	158.1
Accrued salaries, wages and other compensation	144.3	173.5
Accrued expenses and other liabilities	511.4	651.0
Total current liabilities	2,496.3	2,515.4
Long-term debt	4,861.5	5,034.9
Deferred income	78.7	92.2
Deferred income taxes	1,232.3	1,135.3
Other liabilities	660.3	602.8
Total liabilities	9,329.1	9,380.6
Minority interest in consolidated subsidiaries	557.4	559.7
Stockholders equity		
$2.67 Convertible Preferred stock redeemable at Company s option	6.0	6.3
Common stock, par value $3.125 per share, 234.9 shares issued	734.0	734.0
Paid-in capital	657.1	615.7
Accumulated other comprehensive income	125.5	37.9
Retained earnings	6,719.7	6,496.3
Treasury stock, at cost	(3,120.6)	(3,162.2)
Total stockholders equity	5,121.7	4,728.0
Total liabilities and stockholders equity	$ 15,008.2	$ 14,668.3

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Six Months Ended June 30, 2007 and 2006

(in millions, except per share amounts)

(Unaudited)

	2007	2006
Net sales	$ 4,303.6	$ 4,273.9
Cost of products sold	2,334.7	2,269.0
Excise taxes on spirits and wine	219.6	224.4
Advertising, selling, general and administrative expenses	1,023.4	1,016.9
Amortization of intangibles	24.3	19.1
Restructuring charges	13.5	4.0
Operating income	688.1	740.5
Interest expense	163.2	162.3
Other income, net	(17.1)	(20.1)
Income from continuing operations before income taxes and minority interests	542.0	598.3
Income taxes	177.8	168.3
Minority interests	12.0	8.8
Net income	$ 352.2	$ 421.2
Earnings per common share		
Basic	$ 2.31	$ 2.86
Diluted	$ 2.25	$ 2.79
Dividends paid per common share	$ 0.78	$ 0.72
Average number of common shares outstanding		
Basic	152.6	147.1
Diluted	156.3	151.0

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF INCOME

For the Three Months Ended June 30, 2007 and 2006

(in millions, except per share amounts)

(Unaudited)

	2007	2006
Net sales	$ 2,354.8	$ 2,257.1
Cost of products sold	1,249.9	1,184.4
Excise taxes on spirits and wine	121.1	103.6
Advertising, selling, general and administrative expenses	536.8	526.5
Amortization of intangibles	12.2	9.1
Restructuring charges	7.0	(0.1)
Operating income	427.8	433.6
Interest expense	82.1	83.2
Other income, net	(7.7)	(10.1)
Income from continuing operations before income taxes and minority interests	353.4	360.5
Income taxes	115.5	108.6
Minority interests	5.9	4.1
Net income	$ 232.0	$ 247.8
Earnings per common share		
Basic	$ 1.52	$ 1.68
Diluted	$ 1.48	$ 1.63
Dividends paid per common share	$ 0.39	$ 0.36
Average number of common shares outstanding		
Basic	152.8	147.7
Diluted	156.4	151.6

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Months Ended June 30, 2007 and 2006

(in millions)

(Unaudited)

	2007	2006
Operating activities		
Net income	$ 352.2	$ 421.2
Restructuring charges	0.9	4.1
Depreciation and amortization	136.4	131.6
Stock-based compensation	18.3	18.7
Deferred income taxes	(20.6)	(62.1)
Changes in assets and liabilities including effects subsequent to acquisitions:		
(Increase) decrease in accounts receivable	(136.7)	4.2
Decrease (increase) in inventories	0.9	(108.9)
Decrease in accounts payable	(31.9)	(286.2)
(Decrease) increase in accrued expenses and other liabilities	(181.0)	67.6
Increase in accrued taxes	40.0	52.6
Other operating activities, net	(46.5)	(31.1)
Net cash provided by operating activities	132.0	211.7
Investing activities		
Additions to property, plant and equipment	(98.9)	(91.6)
Proceeds from the disposition of property, plant and equipment	4.6	4.2
Acquisitions, net of cash acquired	(6.2)	(592.2)
Net cash used by investing activities	(100.5)	(679.6)
Financing activities		
Decrease in short-term debt and commercial paper, net	(8.7)	(2,132.8)
Issuance of long-term debt		2,939.9
Repayment of long-term debt		(148.9)
Dividends paid to stockholders	(119.3)	(105.8)
Proceeds received from exercise of stock options	42.9	16.2
Tax benefit on exercise of stock options	11.7	3.3
Other financing activities, net	4.6	4.0
Net cash (used) provided by financing activities	(68.8)	575.9
Effect of foreign exchange rate changes on cash	5.4	13.3
Net (decrease) increase in cash and cash equivalents	$ (31.9)	$ 121.3
Cash and cash equivalents at beginning of period	$ 182.7	$ 93.6
Cash and cash equivalents at end of period	$ 150.8	$ 214.9

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY

For the Six Months Ended June 30, 2007 and 2006

(in millions, except per share amounts)

(Unaudited)

	$2.67 Convertible Preferred Stock	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock, At Cost	Total
Balance at December 31, 2005	$ 6.6	$ 717.4	$ 182.8	$ (22.2)	$ 5,890.2	$ (3,129.2)	$ 3,645.6
Comprehensive income							
Net income					421.2		421.2
Changes during the period				48.5			48.5
Total comprehensive income				48.5	421.2		469.7
Dividends ($0.72 per Common share and $1.335 per Preferred share)					(105.8)		(105.8)
Stock-based compensation			10.3			10.3	20.6
Stock issued for SBR acquisition		16.3	365.3			(90.3)	291.3
Excess tax benefit on exercise of stock options			4.3				4.3
Conversion of preferred stock (<0.1 shares)	(0.2)		(1.5)			1.7	
Balance at June 30, 2006	$ 6.4	$ 733.7	$ 570.7	$ 26.3	$ 6,205.6	$ (3,201.9)	$ 4,340.8
Balance at December 31, 2006	$ 6.3	$ 734.0	$ 615.7	$ 37.9	$ 6,496.3	$ (3,162.2)	$ 4,728.0
Comprehensive income							
Net income					352.2		352.2
Changes during the period				87.6			87.6
Total comprehensive income				87.6	352.2		439.8
Adjustment to initially apply FASB Interpretation No. 48					(3.6)		(3.6)
Dividends ($0.78 per Common share and $1.335 per Preferred share)					(119.3)		(119.3)
Stock-based compensation			27.4		(5.9)	39.9	61.4
Excess tax benefit on exercise of stock options			15.4				15.4
Conversion of preferred stock (<0.1 shares)	(0.3)		(1.4)			1.7	
Balance at June 30, 2007	$ 6.0	$ 734.0	$ 657.1	$ 125.5	$ 6,719.7	$ (3,120.6)	$ 5,121.7

See notes to condensed consolidated financial statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

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

The condensed consolidated balance sheet as of June 30, 2007, the related condensed consolidated statements of income for the three-month and six-month periods ended June 30, 2007 and 2006 and the related condensed consolidated statements of cash flows and stockholders equity for the six-month periods ended June 30, 2007 and 2006 are unaudited. In the opinion of management, all adjustments necessary for a fair presentation 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 as permitted by Form 10-Q and do not contain certain information included in our annual consolidated financial statements and notes. The year-end condensed consolidated balance sheet was derived from the audited financial statements, but does not include all disclosures required by generally accepted accounting principles. This Form 10-Q should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2006.

2. Recently Issued Accounting Standards

Fair Value Measurement

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about assets and liabilities measured at fair value. This Statement does not require any new fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (calendar 2008 for Fortune Brands). We are evaluating the impact of FAS 157 on our results of operations and financial position.

Fair Value Option

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. FAS 159 is effective as of the first fiscal year that begins after November 15, 2007 (calendar 2008 for Fortune Brands). We are evaluating the impact of FAS 159 on our results of operations and financial position.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions

Simonton Acquisition

On June 7, 2006, we completed the acquisition of SBR, Inc. (Simonton), a privately held company consisting of brands including Simonton Windows, a leading vinyl-framed window brand in North America. The purchase price was approximately $599.8 million, net of cash acquired and including assumed debt. The consideration paid included stock (based on the price of Fortune Brands common stock at closing) and cash. The stock component was 50% of the total purchase price. We assumed $85.9 million of Simonton s debt, of which $55.4 million was paid off at closing. Simonton is included in consolidated results from the date of acquisition. The acquisition is not material for the purposes of supplemental disclosure in accordance with Statement of Financial Accounting Standards No. 141 (FAS 141), Business Combinations.

Acquisition of Spirits and Wine Brands and Assets

In July 2005, the Company purchased more than 25 spirits and wine brands as well as certain distribution assets (the Pernod Ricard Acquired Assets) from Pernod Ricard S.A. (Pernod Ricard). Brands acquired include Sauza tequila, Maker s Mark bourbon, Courvoisier cognac, Canadian Club whisky, Laphroaig single-malt Scotch, Clos du Bois super-premium wines, leading regional and national brands and distribution operations in the U.K., Germany and Spain, and with respect to wine, in the U.S.

As of January 27, 2006, substantially all of the Pernod Ricard Acquired Assets were legally transferred to Fortune Brands. We reached an agreement with Pernod Ricard at that date to adjust the global consideration for the Pernod Ricard Acquired Assets as a result of higher actual historical profits than anticipated, working capital adjustments and additional adjustments to achieve economic results consistent with the parties intention to complete the Company s acquisition of the Pernod Ricard Acquired Assets on a cash-free and debt-free basis. The net payment made in the second quarter of 2006 was £134.3 million (approximately $252 million), and was allocated to goodwill.

4. Goodwill and Other Intangible Assets

We had goodwill of $4,350.9 million as of June 30, 2007. The increase in goodwill of $5.3 million during the six months ended June 30, 2007 was due to foreign currency translation adjustments and the acquisition of Simonton, partly offset by acquisition-related adjustments related to the Pernod Ricard Acquired Assets.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Goodwill and Other Intangible Assets (Continued)

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

(in millions)	Balance at December 31, 2006	Acquisition-Related Adjustments	Translation Adjustments	Balance at June 30, 2007
Home and Hardware	$ 1,917.7	$ 3.1	$ 0.9	$ 1,921.7
Spirits and Wine	2,416.1	(19.0)	20.3	2,417.4
Golf	11.8			11.8
Total goodwill, net	$ 4,345.6	$ (15.9)	$ 21.2	$ 4,350.9

We also had indefinite-lived intangibles, principally tradenames, of $3,371.8 million and $3,338.4 million as of June 30, 2007 and December 31, 2006, respectively. The increase of $33.4 million was due to changes in foreign currency rates.

Amortizable identifiable intangible assets, principally tradenames, are subject to amortization over their estimated useful life, 5 to 30 years, based on the assessment of a number of factors that may impact useful lives. 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, financial results and other relevant factors.

The gross carrying value and accumulated amortization by class of intangible assets as of June 30, 2007 and December 31, 2006 are as follows:

	As of June 30, 2007			As of December 31, 2006		
(in millions)	Gross Carrying Amounts	Accumulated Amortization	Net Book Value	Gross Carrying Amounts	Accumulated Amortization	Net Book Value
Indefinite-lived intangible assets	$ 3,446.0	$ (74.2)[1]	$ 3,371.8	$ 3,412.6	$ (74.2)[1]	$ 3,338.4
Amortizable intangible assets						
Tradenames	495.9	(142.3)	353.6	491.8	(134.7)	357.1
Customer and contractual relationships	397.6	(85.9)	311.7	397.3	(71.9)	325.4
Patents/proprietary technology	81.9	(19.7)	62.2	81.9	(16.6)	65.3
Licenses and other	15.3	(4.7)	10.6	15.3	(4.6)	10.7
Total	990.7	(252.6)	738.1	986.3	(227.8)	758.5
Total identifiable intangibles	$ 4,436.7	$ (326.8)	$ 4,109.9	$ 4,398.9	$ (302.0)	$ 4,096.9

(1) Accumulated amortization prior to the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Income Taxes

The effective income tax rate for the six months ended June 30, 2007 and 2006 was 32.8% and 28.1%, respectively. The effective income tax rate for the three months ended June 30, 2007 and 2006 was 32.7% and 30.1%, respectively. The increase in the effective rate in both periods was partly due to $15.3 million of tax credits recorded in the second quarter of 2006 resulting from the favorable resolution of routine state tax audits. The increase in the effective income tax rate for the six months ended June 30, 2007 was also due to the absence of tax-related credits of $22.3 million recorded in the first quarter of 2006, mainly resulting from the favorable conclusion of the Internal Revenue Service s examination phase of the routine review of our 2002-2003 tax returns. The effective income tax rates in both periods benefited from reduced foreign taxes.

On January 1, 2007, we adopted FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109. FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, disclosure and transition. The evaluation of a tax position in accordance with FIN 48 is a two step process. The first step is recognition, where we evaluate whether an individual tax position has a likelihood of greater than 50% of being sustained upon examination based on the technical merits of the position, including resolution of any related appeals or litigation processes. For tax positions that are currently estimated to have a less than 50% likelihood of being sustained, zero tax benefit is recorded. For tax positions that have met the recognition threshold in the first step, we perform the second step of measuring the benefit to be recorded. The actual benefits ultimately realized may differ from the Company s estimates. In future periods, changes in facts, circumstances, and new information may require the Company to change the recognition and measurement estimates with regard to individual tax positions. Changes in recognition and measurement estimates are recorded in results of operations and financial position in the period in which such changes occur.

Differences between the amounts recognized in our statement of financial position prior to the adoption of FIN 48 and the amounts recognized after adoption are accounted for as a cumulative effect adjustment recorded to our beginning balance of retained earnings. The cumulative effect adjustment of $3.6 million was recognized as a decrease to beginning retained earnings upon implementation of FIN 48 on January 1, 2007.

The total amount of unrecognized tax benefits as of January 1, 2007 was $207.8 million. The amount of unrecognized tax benefits that, if recognized as of January 1, 2007, would affect the Company s effective tax rate was $190.3 million.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Income Taxes (Continued)

The Company or its subsidiaries file income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. The U.S. Internal Revenue Service (IRS) is currently examining the Company s 2004 and 2005 federal income tax returns; however the Company is technically subject to IRS examination for the years 1997 through 2003 due to unexpired statute of limitations periods. The Company or one of its subsidiaries is subject to non-U.S. income taxes examination by tax authorities in the following major taxing jurisdictions: Canada for years after 1998, France for years after 2003, Mexico for years after 2001, Spain for years after 1999, and the United Kingdom for years after 2003.

It is reasonably possible that, within the next twelve months, total unrecognized tax benefits may decrease in the range of $75 to $85 million primarily as a result of the conclusion of U.S. federal and state income tax proceedings.

We continue to apply our accounting policy of classifying interest and penalties accruals related to unrecognized tax benefits as income tax expense. The total amount of accrued interest and penalties as of January 1, 2007 was $33.3 million and $11.9 million, respectively.

6. Information on Business Segments

Net sales and operating income for the six months ended June 30, 2007 and 2006 by segment were as follows:

	Six Months Ended June 30,		% Change
(in millions)	**2007**	**2006**	**vs. Prior Year**
Net Sales			
Home and Hardware	$ 2,224.7	$ 2,226.2	(0.1)%
Spirits and Wine	1,237.2	1,249.7	(1.0)
Golf	841.7	798.0	5.5
Net Sales	$ 4,303.6	$ 4,273.9	0.7%
Operating Income			
Home and Hardware	$ 256.3	$ 349.7	(26.7)%
Spirits and Wine	321.2	285.5	12.5
Golf	142.2	140.5	1.2
Less:			
Corporate expenses	31.6	35.2	10.2%
Operating Income	$ 688.1	$ 740.5	(7.1)%

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Information on Business Segments (Continued)

Net sales and operating income for the three months ended June 30, 2007 and 2006 by segment were as follows:

(in millions)	Three Months Ended June 30, 2007	2006	% Change vs. Prior Year
Net Sales			
Home and Hardware	$ 1,202.1	$ 1,193.8	0.7%
Spirits and Wine	678.1	637.8	6.3
Golf	474.6	425.5	11.5
Net Sales	$ 2,354.8	$ 2,257.1	4.3%
Operating Income			
Home and Hardware	$ 169.9	$ 209.9	(19.1)%
Spirits and Wine	186.3	157.3	18.4
Golf	88.6	82.1	7.9
Less:			
Corporate expenses	17.0	15.7	(8.3)%
Operating Income	$ 427.8	$ 433.6	(1.3)%

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Earnings Per Share

The computation of basic and diluted earnings per common share (EPS) is as follows:

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
(in millions, except for per share amounts)	2007	2006	2007	2006
Net income	$ 352.2	$ 421.2	$ 232.0	$ 247.8
Less: Preferred stock dividends	0.3	0.3	0.2	0.1
Income available to common stockholders basic	351.9	420.9	231.8	247.7
Convertible Preferred stock dividends	0.3	0.3	0.2	0.1
Income available to common stockholders diluted	$ 352.2	$ 421.2	$ 232.0	$ 247.8
Weighted average number of common shares outstanding basic	152.6	147.1	152.8	147.7
Conversion of Convertible Preferred stock	1.3	1.4	1.3	1.4
Exercise of stock options	2.4	2.5	2.3	2.4
Weighted average number of common shares outstanding diluted	156.3	151.0	156.4	151.5
Earnings per common share				
Basic	$ 2.31	$ 2.86	$ 1.52	$ 1.68
Diluted	$ 2.25	$ 2.79	$ 1.48	$ 1.63

For the six and three months ended June 30, 2007 and 2006, certain stock options were excluded from the calculation of weighted average shares for diluted EPS because they were antidilutive (the exercise price exceeded the average stock price). For the six months ended June 30, 2007 and 2006, these excluded stock options were 4.1 million shares and 2.7 million shares of weighted average shares outstanding, respectively. For the three months ended June 30, 2007 and 2006, these excluded stock options were 4.0 million shares and 2.7 million shares of weighted average shares outstanding, respectively.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Pension and Other Retiree Benefits

The components of net periodic benefit cost for pension and postretirement benefits for the six months ended June 30, 2007 and 2006 were as follows:

	Six Months Ended June 30,			
	Pension Benefits		Postretirement Benefits	
(in millions)	2007	2006	2007	2006
Service cost	$ 17.4	$ 17.4	$ 2.1	$ 2.1
Interest cost	26.8	24.0	4.9	4.9
Expected return on plan assets	(31.0)	(29.1)		
Amortization of prior service cost	1.3	1.4	(0.8)	(0.7)
Amortization of net actuarial loss	6.9	7.7	1.2	2.1
Net periodic benefit cost	$ 21.4	$ 21.4	$ 7.4	$ 8.4

The components of net periodic benefit cost for pension and postretirement benefits for the three months ended June 30, 2007 and 2006 were as follows:

	Three Months Ended June 30,			
	Pension Benefits		Postretirement Benefits	
(in millions)	2007	2006	2007	2006
Service cost	$ 8.7	$ 8.7	$ 1.0	$ 1.1
Interest cost	13.5	12.1	2.5	2.4
Expected return on plan assets	(15.5)	(14.6)		
Amortization of prior service cost	0.6	0.7	(0.4)	(0.4)
Amortization of net actuarial loss	3.5	3.9	0.6	1.1
Net periodic benefit cost	$ 10.8	$ 10.8	$ 3.7	$ 4.2

9. Long-Term Debt

Based on the long-term credit facilities which support our commercial paper borrowings, commercial paper borrowings totaling $1.0 billion were classified as long-term on the condensed consolidated balance sheets as of June 30, 2007 and December 31, 2006, as the Company has the intent and ability to refinance this obligation on a long-term basis.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Financial Instruments

We do not enter into financial instruments for trading or speculative purposes. Financial instruments are principally used to reduce the impact of changes in foreign currency exchange rates, interest rates and commodities used as raw materials in our products. The principal financial instruments used are forward foreign exchange contracts, interest rate swaps and commodity swaps. There were no interest rate swaps outstanding during the first six months of 2007.

We enter into forward foreign exchange contracts principally to hedge currency fluctuations in transactions denominated in foreign currencies, thereby limiting our risk that would otherwise result from changes in exchange rates. The periods of the forward foreign exchange contracts correspond to the periods of the hedged transactions. We also enter into forward foreign exchange contracts to hedge a portion of our net investments in certain foreign subsidiaries. We enter into commodity swaps that correspond to periods of forecasted commodity purchases. We account for these commodity derivatives as either cash flow or economic hedges. The effective portion of cash flow hedges is reported in accumulated other comprehensive income. The ineffective portion of all hedges is recognized in current period earnings. Changes in the fair value of economic hedges are recorded directly into current period earnings.

The counterparties are major financial institutions. Although our theoretical risk is the replacement cost at the then estimated fair value of these instruments, management believes that the risk of incurring losses is remote and that the losses, if any, would be immaterial. The estimated fair value of contracts represents the amount required to enter into offsetting contracts with similar remaining maturities based on quoted market prices.

11. Guarantees and Commitments

As of June 30, 2007, we had third-party guarantees totaling approximately $85 million. These represent guarantees of the debt of Maxxium Worldwide B.V. (Maxxium), our Spirits and Wine business international sales and distribution joint venture. We are required to perform under these guarantees in the event that Maxxium fails to make contractual payments. The current guarantees of Maxxium s credit facilities expire December 12, 2010. In accordance with Financial Accounting Standards Board Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, a liability, with an offsetting increase in the investment in Maxxium, of $0.5 million existed as of June 30, 2007 to reflect the fair value of the guarantees to Maxxium.

In addition, as a part of the formation of the Future Brands LLC (Future Brands) joint venture with V&S Group, Jim Beam Brands Co. (JBBCo.) guaranteed any financial obligations of Future Brands that may arise in the event of a Future Brands default in which it fails to fulfill its operating obligations and which results in a claim. These financial obligations include, but are not limited to, making payments to suppliers, employees and other parties with which Future Brands conducts business. We cannot estimate the possible future obligations under the Future Brands guarantee. At June 30, 2007, JBBCo. did not have any outstanding obligations as a result of this arrangement.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Guarantees and Commitments (Continued)

We also guaranteed various leases for ACCO World Corporation, the Office business divested in a spin-off on August 16, 2005. We will continue to guarantee payment of certain real estate leases, with lease payments totaling approximately $39 million, through April 2013. Accordingly, we have recorded the fair value of these guarantees on our financial statements in accordance with FIN 45. The liability related to this guarantee was $1.2 million as of June 30, 2007.

We have provided typical indemnities in connection with divestitures. These indemnities relate to various representations generally included in divestiture agreements, such as environmental, tax, product liability, employee liability and other contingencies, depending on the transactions. In several of these divestitures, a maximum obligation for certain contingencies is not specified, which is not unusual for these transactions. Pursuant to FIN 45, we cannot reasonably estimate potential payments under these divestiture-related indemnity obligations. The indemnities vary in duration, and in some cases the durations are indefinite. Because FIN 45 was effective after December 31, 2002, we have not recorded any liability in the consolidated financial statements for indemnities entered into prior to that date. We have not made any indemnity payments that were material to our financial position or results of operations for any quarter. Furthermore, we do not expect that any potential payments in connection with any of these indemnity obligations would have a material adverse effect on our consolidated financial position, results of operations or liquidity for 2007 or in future periods.

12. Product Warranties

We generally record warranty expense at the time of sale. We offer our customers various warranty terms based upon the type of product sold.

The following table summarizes activity related to our product warranty liability during the six and three months ended June 30, 2007 and 2006:

	Six Months Ended		Three Months Ended	
	June 30,		June 30,	
(in millions)	2007	2006	2007	2006
Balance at the beginning of the period	$ (15.0)	$ (13.0)	$ (15.4)	$ (13.7)
Provision for warranties issued	(20.6)	(20.7)	(11.0)	(10.8)
Acquisitions		(1.2)		(1.2)
Settlements made (in cash or in kind)	19.8	19.1	10.6	9.9
Balance at the end of the period	$ (15.8)	$ (15.8)	$ (15.8)	$ (15.8)

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Restructuring and Restructuring-Related Charges

Pre-tax restructuring and restructuring-related charges for the six and three months ended June 30, 2007 and 2006 are shown below. The restructuring liabilities as of June 30, 2007 and December 31, 2006 were not material.

	Six Months Ended June 30, 2007			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A	Charges
Home and Hardware	$ 10.4	$ 6.3	$ 0.4	$ 17.1
Spirits and Wine	3.1			3.1
	$ 13.5	$ 6.3	$ 0.4	$ 20.2

	Three Months Ended June 30, 2007			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A	Charges
Home and Hardware	$ 6.6	$ 3.5	$ 0.3	$ 10.4
Spirits and Wine	0.4			0.4
	$ 7.0	$ 3.5	$ 0.3	$ 10.8

	Six Months Ended June 30, 2006			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A	Charges
Home and Hardware	$ 4.1	$ 4.7	$ 0.4	$ 9.2
Spirits and Wine	(0.1)		3.1	3.0
	$ 4.0	$ 4.7	$ 3.5	$ 12.2

	Three Months Ended June 30, 2006			
	Restructuring	Restructuring-Related		Total
(in millions)	Charges	Cost of Sales	ASG&A	Charges
Home and Hardware	$	$	$ 0.4	$ 0.4
Spirits and Wine	(0.1)		1.3	1.2
	$ (0.1)	$	$ 1.7	$ 1.6

Home and Hardware charges in 2007 principally related to cost reduction initiatives including facility consolidations (closing several manufacturing facilities and one distribution center) and workforce reductions to better align our supply chain with anticipated demand. Home and Hardware charges in 2006 related to supply-chain initiatives. Spirits and Wine charges in 2007 primarily related to a distribution model change in Australia. Spirits and Wine charges in 2006 related to the integration of the Spirits and Wine acquisition.

We expect all projects to be completed in the next twelve months.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. Comprehensive Income

Total comprehensive income consists of net income and other changes in stockholders equity from transactions and other events from sources other than stockholders. It includes currency translation gains and losses, unrealized gains and losses from derivative instruments designated as cash flow hedges, deferred net gains on treasury rate locks, and amortization of unrecognized net periodic pension and postretirement cost. Included in the foreign currency adjustments balance at June 30, 2007 were deferred losses of $5.4 million related to the hedging of anticipated transactions denominated in foreign currencies.

Total comprehensive income for the three months ended June 30, 2007 and 2006 was $328.9 million and $301.4 million, respectively. The difference between total comprehensive income and net income was primarily attributable to currency translation gains and losses in the six and three months ended June 30, 2007 of $83.0 million and $95.4 million, respectively.

15. Pending Litigation

Tobacco Litigation and Indemnification

On December 22, 1994, we sold The American Tobacco Company (ATCO) subsidiary to Brown & Williamson Tobacco Corporation (B&W), at the time a wholly-owned subsidiary of B.A.T. Industries p.l.c. In connection with the sale, B&W and ATCO, which subsequently merged into B&W, agreed, under an Indemnification Agreement (the Indemnification Agreement), to indemnify Fortune Brands, Inc. against claims including legal expenses arising from smoking and health and fire safe cigarette matters relating to the tobacco business of ATCO.

On July 30, 2004, B&W and R.J. Reynolds Tobacco Holdings, Inc. announced that they had completed the combination of their respective U.S. tobacco businesses, previously conducted by B&W (and ATCO) and R.J. Reynolds Tobacco Co., by forming a new combined company known as R.J. Reynolds Tobacco Company. As a result of the combination and in accordance with the Indemnification Agreement, the new R.J. Reynolds Tobacco Company has assumed the indemnification obligations under the Indemnification Agreement relating to the U.S. business previously conducted by B&W (and ATCO). B&W has not been released from any of its obligations under the Indemnification Agreement. We refer to B&W and the new R.J. Reynolds Tobacco Company as the Indemnitor under the Indemnification Agreement.

The Indemnitor has complied with the terms of the Indemnification Agreement since 1994 and we are not aware of any inability on the part of the Indemnitor to satisfy its indemnity obligations.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

15. Pending Litigation (Continued)

Tobacco Litigation and Indemnification (Continued)

The Company is a defendant in a number of actions based upon allegations that human ailments have resulted from tobacco use. It is not possible to predict the outcome of the pending litigation, and, as with any litigation, it is possible that some of these actions could be decided unfavorably. We are unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the pending litigation. However, we believe that there are a number of meritorious defenses to the pending actions, including the fact that the Company never made or sold tobacco, and these actions are being vigorously contested by the Indemnitor. We believe that the pending actions will not have a material adverse effect upon our results of operations, cash flows or financial condition because we believe we have meritorious defenses and the Company is indemnified under the Indemnification Agreement.

Other Litigation

The Company, its Spirits and Wine business and numerous other manufacturers and importers of beer, spirits and wine were named as defendants in purported class action lawsuits in Michigan, Ohio, Wisconsin and West Virginia seeking damages and injunctive relief regarding alleged deceptive and negligent marketing of beverage alcohol to people under the legal purchase age for alcohol. All of these actions were dismissed at the trial court level. The Michigan and Ohio cases were remanded to the trial court to be dismissed and vacated for lack of standing, and the Wisconsin and West Virginia cases are currently pending on appeal. The Company believes that the Company and its Spirits and Wine business have meritorious defenses against all of these allegations and that these actions will not have a material adverse effect on our results of operations, cash flows or financial condition. The Company and its Spirits and Wine business are vigorously contesting this litigation.

On March 7, 2005, Bridgestone Sports Co., Ltd and Bridgestone Golf, Inc. (collectively, Bridgestone) filed a lawsuit against Acushnet Company (one of the Company s subsidiaries) in the United States District Court for the District of Delaware. The Bridgestone complaint alleges that various golf balls manufactured by Acushnet Company (Acushnet) violate ten of Bridgestone s U.S. patents. The Company believes, and counsel has advised, that Acushnet has meritorious defenses against plaintiffs claims. In addition, Acushnet filed a counterclaim in the action seeking damages for infringement of five of its patents. In June 2007, Acushnet entered into a preliminary settlement agreement with Bridgestone that resolves all claims asserted by the parties in this action. The Company believes that the ultimate resolution of this matter will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Concluded)

15. Pending Litigation (Continued)

Other Litigation (Continued)

On February 9, 2006, Callaway Golf Company filed a lawsuit against Acushnet Company in the United States District Court for the District of Delaware. Callaway alleges that certain golf balls manufactured by Acushnet Company infringe four of Callaway s patents. Acushnet believes, and counsel has advised that, it has meritorious defenses against Callaway s allegations. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that this action could be decided unfavorably. Acushnet is vigorously contesting this action and the Company believes that the lawsuit will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition.

On June 8, 2007, Callaway Golf Company filed a lawsuit against Acushnet Company in the United States District Court for the District of Delaware. Callaway alleges that certain golf clubs manufactured by Acushnet Company infringe five of Callaway s patents. Acushnet believes, and counsel has advised that, it has meritorious defenses against Callaway s allegations. It is not possible to predict the outcome of pending litigation, and, as with any litigation, it is possible that this action could be decided unfavorably. Acushnet is vigorously contesting this action and the Company believes that the lawsuit will not have a material adverse effect on the results of the Company s operations, cash flows or financial condition. In addition, Acushnet filed a counterclaim in the action seeking damages for infringement of two of its patents.

In addition to the lawsuits described above, the Company and its subsidiaries are defendants in lawsuits associated with their businesses and operations. It is not possible to predict the outcome of the pending actions, and, as with any litigation, it is possible that some of these actions could be decided unfavorably. We believe 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. These actions are being vigorously contested.

16. Environmental

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

Item 2. FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

Fortune Brands, Inc. is a holding company with subsidiaries that make and sell leading consumer branded products in the following industries: spirits and wine, home and hardware, and golf products. We enhance shareholder value by profitably building our leading consumer brands to drive sales and earnings as well as to generate cash. We do this by developing innovative new products and effective marketing campaigns, and expanding customer relationships. We also seek to increase profits by improving operations, increasing productivity and enhancing cost structures. While our first priority is internal growth, we also strive to achieve growth and high returns through acquisitions, dispositions and joint ventures. Finally, we enhance shareholder value through other initiatives such as using our financial resources to pay attractive dividends and repurchase shares.

In June 2006, we acquired SBR, Inc. (Simonton), a leading vinyl-framed window brand in North America, and its other related businesses for approximately $599.8 million (based on the price of Fortune Brands common stock at closing). Based on this valuation, the stock component was 50% of the total purchase price. For more information on this acquisition, refer to Note 4, Acquisitions, Disposals and Joint Ventures, and Note 6, Long-Term Debt, in the Notes to the Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended December 31, 2006.

For a description of certain factors that may have had, or may in the future have, a significant impact on our business, financial condition or results of operations, see Forward-Looking Statements.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS

Six Months Ended June 30, 2007 Compared To Six Months Ended June 30, 2006

	Net Sales		
			% Change
(in millions)	2007	2006	vs. Prior Year
Home and Hardware	$ 2,224.7	$ 2,226.2	(0.1)%
Spirits and Wine	1,237.2	1,249.7	(1.0)
Golf	841.7	798.0	5.5
Net Sales	$ 4,303.6	$ 4,273.9	0.7%

	Operating Income		
			% Change
	2007	2006	vs. Prior Year
Home and Hardware	$ 256.3	$ 349.7	(26.7)%
Spirits and Wine	321.2	285.5	12.5
Golf	142.2	140.5	1.2
Less:			
Corporate expenses	31.6	35.2	10.2%
Operating Income	$ 688.1	$ 740.5	(7.1)%

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Net Sales

Net sales increased $29.7 million, or 0.7%, to $4.3 billion due to:

- the benefit of the Simonton acquisition ($182 million),
- newly introduced products and line extensions across all businesses (approximately $211 million in total, net of discontinued products),
- strong international growth,
- favorable foreign currency and
- targeted price increases implemented to offset higher commodity costs, primarily in the Home & Hardware and Spirits & Wine businesses.

Net sales were negatively impacted by the downturn in the U.S. home products markets and its impact on our Home and Hardware business.

Cost of products sold

Cost of products sold increased $65.7 million, or 2.9%, primarily on increased commodity costs (approximately $60 million, net of related commodity hedge gains and losses) and the acquisition of Simonton, partly offset by productivity improvements.

Excise taxes on spirits and wine

Excise taxes on spirits and wine decreased as a percentage of sales primarily since, in Spain, we now distribute through our selling and distribution joint venture, where we do not pay excise taxes, compared to direct selling in the first quarter of 2006. Excise taxes are generally levied based on the alcohol content of spirits and wine products. Consistent with industry practice, excise taxes collected from customers are reflected in net sales and the corresponding payments to the government in expenses.

Advertising, selling, general and administrative expenses

Advertising, selling, general and administrative expenses increased $6.5 million, or 0.6%, primarily as a result of the impact of the Simonton acquisition, partly offset by the benefit of cost reduction initiatives, particularly in the Home and Hardware business, and lower advertising and promotion expenses in the Spirits and Wine business due to a shift in the timing of spending to the second half of the year.

Amortization of intangibles

Amortization of intangibles increased $5.2 million to $24.3 million, primarily due to amortization of intangible assets associated with the June 2006 Simonton acquisition.

FORTUNE BRANDS, INC. AND SUBSIDIARIES

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Continued)

RESULTS OF OPERATIONS (Continued)

Restructuring charges

For the six months ended June 30, 2007, we recorded restructuring charges of $13.5 million principally related to cost reduction initiatives in the Home and Hardware business, as well as a change in the distributor for spirits products in Australia. In the Home and Hardware business, we closed several manufacturing facilities and a distribution center to better align our supply chain with anticipated demand. In the six months ended June 30, 2006, we recorded restructuring charges of $4.0 million primarily related to supply-chain initiatives and asset write-downs related to the Home and Hardware business.

Interest expense

Interest expense increased $0.9 million, or 0.6%, to $163.2 million due to an increase in commercial paper rates, partly offset by lower average debt.

Other income, net

Other income, net decreased $3.0 million to $17.1 million primarily as a result of foreign currency transaction losses. Other income, net, includes non-operating income and expense, such as amortization of deferred income related to Future Brands LLC (our U.S. distribution joint venture), interest income and foreign currency transaction gains/losses.

Income taxes

The effective income tax rate for the six months ended June 30, 2007 and 2006 was 32.8% and 28.1%, respectively. The increase in the effective rate primarily resulted from the absence of 2006 tax credits of $38.6 million associated with the resolution of certain Internal Revenue Service and routine state tax audits, partly offset by reduced foreign taxes in 2007.

Minority interests

Minority interest expense increased $3.2 million to $12.0 million, primarily due to higher dividends paid to V&S Group as a result of an additional investment in the Spirits and Wine business in 2006. Refer to Note 4, Acquisitions, Disposal and Joint Ventures, in the Notes to the Consolidated Financial Statements in our Annual Report