Fortune Brands Home & Security, Inc.
Form 10-Q
October 30, 2015

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 September 30, 2015

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	**62-1411546**
(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 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). x Yes ¨ No

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

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

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

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, at October 23, 2015 was 159,695,840.

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, 2015 and 2014

(In millions, except per share amounts)

(Unaudited)

	Nine Months Ended September 30,		Three Months Ended September 30,	
	2015	2014	2015	2014
Net sales	$ 3,354.7	$ 2,974.0	$ 1,238.8	$ 1,057.7
Cost of products sold	2,192.9	1,948.9	804.3	689.7
Selling, general and administrative expenses	778.1	690.2	265.7	234.9
Amortization of intangible assets	15.3	9.5	6.7	3.4
Restructuring charges	12.6	1.1	1.8	0.2
Operating income	355.8	324.3	160.3	129.5
Interest expense	20.5	7.2	11.1	3.2
Other expense (income), net	3.7		0.5	(0.5)
Income from continuing operations before income taxes	331.6	317.1	148.7	126.8
Income taxes	112.7	100.0	48.7	42.3
Income from continuing operations, net of tax	218.9	217.1	100.0	84.5
Income (loss) from discontinued operations, net of tax	8.6	(103.2)	7.8	(105.4)
Net income (loss)	227.5	113.9	107.8	(20.9)
Less: Noncontrolling interests	0.3	0.9	0.3	0.2
Net income (loss) attributable to Fortune Brands	$ 227.2	$ 113.0	$ 107.5	$ (21.1)
Basic earnings per common share				
Continuing operations	$ 1.37	$ 1.33	$ 0.62	$ 0.53
Discontinued operations	0.06	(0.64)	0.05	(0.66)
Net income (loss) attributable to Fortune Brands common shareholders	$ 1.43	$ 0.69	$ 0.67	$ (0.13)

Diluted earnings per common share								
Continuing operations	$	1.34	$	1.29	$	0.61	$	0.52
Discontinued operations		0.05		(0.62)		0.05		(0.65)
Net income (loss) attributable to Fortune Brands common shareholders	$	1.39	$	0.67	$	0.66	$	(0.13)
Comprehensive income (loss)	$	195.1	$	95.7	$	93.2	$	(31.2)

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions)

(Unaudited)

	September 30, 2015		December 31, 2014	
Assets				
Current assets				
Cash and cash equivalents	$	350.6	$	191.9
Accounts receivable, net		557.0		458.9
Inventories		540.4		462.2
Other current assets		175.4		122.8
Current assets of discontinued operations				63.3
Total current assets		1,623.4		1,299.1
Property, plant and equipment, net of accumulated depreciation		606.3		539.8
Goodwill		1,800.8		1,467.8
Other intangible assets, net of accumulated amortization		982.2		656.5
Other assets		69.5		72.4
Non-current assets of discontinued operations				17.3
Total assets	$	5,082.2	$	4,052.9
Liabilities and equity				
Current liabilities				
Current portion of long-term debt	$	3.8	$	26.3
Accounts payable		353.6		333.8
Other current liabilities		420.3		322.0
Current liabilities of discontinued operations				17.5
Total current liabilities		777.7		699.6
Long-term debt		1,337.6		643.7
Deferred income taxes		266.0		150.6
Other non-current liabilities		296.6		292.5
Non-current liabilities of discontinued operations				3.4
Total liabilities		2,677.9		1,789.8
Commitments and contingencies (see Note 17)				
Equity				
Fortune Brands stockholders equity				
Common stock[(a)]		1.7		1.7
Paid-in capital		2,581.7		2,517.3

Accumulated other comprehensive loss		(39.1)		(6.7)
Retained earnings		439.4		279.5
Treasury stock		(582.1)		(532.3)
Total Fortune Brands stockholders equity		2,401.6		2,259.5
Noncontrolling interests		2.7		3.6
Total equity		2,404.3		2,263.1
Total liabilities and equity	$	5,082.2	$	4,052.9

[(a)] *Common stock, par value $0.01 per share; 174.5 million shares and 172.0 million shares issued at September 30, 2015 and December 31, 2014, 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, 2015 and 2014

(In millions)

(Unaudited)

	2015	2014
Operating activities		
Net income	$ 227.5	$ 113.9
Non-cash pre-tax expense (income):		
Depreciation	66.5	60.9
Amortization	15.3	12.3
Stock-based compensation	20.6	23.9
Recognition of actuarial losses	8.9	1.7
Deferred income taxes	(22.7)	5.6
Restructuring charges	0.9	0.4
Amortization of deferred financing costs	0.4	
Pre-tax loss on sale of discontinued operations	16.9	83.2
(Income) loss on sale of property, plant and equipment	(0.7)	0.5
Changes in assets and liabilities:		
Increase in accounts receivable	(57.7)	(77.6)
Increase in inventories	(52.7)	(34.5)
Increase (decrease) in accounts payable	5.6	(3.6)
Increase in other assets	(11.2)	(15.1)
Increase (decrease) in accrued expenses and other liabilities	21.9	(104.5)
Increase in accrued taxes	24.6	43.1
Net cash provided by operating activities	264.1	110.2
Investing activities		
Capital expenditures	(86.9)	(82.3)
Proceeds from the disposition of assets	2.5	0.2
Proceeds from sale of discontinued operations	12.2	130.0
Cost of acquisitions, net of cash acquired	(652.8)	(118.5)
Other investing activities		(7.0)
Net cash used in investing activities	(725.0)	(77.6)
Financing activities		
Decrease in short-term debt, net		(2.7)
Issuance of long-term debt	1,748.9	835.0
Repayment of long-term debt	(1,080.0)	(505.0)
Proceeds from the exercise of stock options	22.6	23.1

Treasury stock purchases[a]	(15.7)	(411.4)
Excess tax benefit from the exercise of stock-based compensation	23.0	24.4
Dividends to stockholders[b]	(67.1)	(58.5)
Other financing, net	(1.2)	(2.2)
Net cash provided by (used in) financing activities	630.5	(97.3)
Effect of foreign exchange rate changes on cash	(10.9)	(1.6)
Net increase (decrease) in cash and cash equivalents	$ 158.7	$ (66.3)
Cash and cash equivalents at beginning of period	$ 191.9	$ 241.4
Cash and cash equivalents at end of period	$ 350.6	$ 175.1

[a] *Treasury stock purchases exclude purchases of $20.3 million of shares of common stock in September 2015 that were not settled until October 2015.*

[b] *Excludes dividends declared but not paid of $22.3 million and $19.0 million as of September 30, 2015 and 2014, respectively.*

See notes to condensed consolidated financial statements.

FORTUNE BRANDS HOME & SECURITY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

For the Nine Months Ended September 30, 2015 and 2014

(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, 2013	$ 1.7	$ 2,431.3	$ 95.4	$ 200.8	$ (79.8)	$ 3.7	$ 2,653.1
Comprehensive income:							
Net income				113.0		0.9	113.9
Other comprehensive income			(18.1)			(0.1)	(18.2)
Stock options exercised		23.1					23.1
Stock-based compensation		23.8			(8.8)		15.0
Tax benefit on exercise of stock options		24.7					24.7
Tax-related adjustments		(1.2)					(1.2)
Treasury stock purchase					(411.4)		(411.4)
Dividends ($0.36 per common share)				(57.3)			(57.3)
Dividends paid to noncontrolling interests						(1.1)	(1.1)
Balance at September 30, 2014	$ 1.7	$ 2,501.7	$ 77.3	$ 256.5	$ (500.0)	$ 3.4	$ 2,340.6
Balance at December 31, 2014	$ 1.7	$ 2,517.3	$ (6.7)	$ 279.5	$ (532.3)	$ 3.6	$ 2,263.1
Comprehensive income:							
Net income				227.2		0.3	227.5
Other comprehensive income			(32.4)				(32.4)
Stock options exercised		22.7					22.7
Stock-based compensation		20.5			(13.8)		

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The Company completed a sale of its common stock and warrants to purchase common stock in January 2000. In addition to the conversion of notes outstanding referred to above, the Company received $13,898,500 in cash from various investors, including some directors and employees of the company, in exchange for 4,808,375 shares of common stock and 4,808,375 warrants to purchase common stock, offset by approximately $1,103,000 in transactions costs. The price per share of common stock was $4.00, which included the issuance of one warrant for each share of stock sold. Each warrant is exercisable for one share of common stock at an exercise price of $5.00 per share and expires 5 years from the date of issue. Compensation expense of $77,726 was recorded as a result of sales of stock to employees for the excess of fair value over the price paid. In connection with the offering, 98,870 five-year warrants to purchase common stock at $8.4375 per share were issued to the placement agent.

(8) STOCK OPTIONS

In January 2001 the Company granted options to purchase 150,000 shares of common stock exercisable at $0.3125 to an independent contractor. In addition, existing options for employees under variable plan accounting and unvested options being earned by contractors were revalued, resulting in a net reduction in stock-based compensation of $250,000 as of March 31, 2001.

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As a result of severance agreements with certain senior officials, the lives of their options were extended to one year after termination or the full contractual life instead of expiring within a shorter time. These extensions, which have been approved by management but not yet ratified by the Board, resulted in a stock-based compensation charge of $616,000. The severance-related portion of stock-based compensation is included in Restructuring costs in the accompanying Consolidated Statements of Operations.

The Company granted options to purchase 90,250 shares of common stock to employees on February 1, 2000. Of these options, options to purchase 45,125 shares were issued with an exercise price of $4.00 per share and expiring on April 30, 2000. The remaining options to purchase 45,125 shares were issued with an exercise price of $5.00 per share and expire 5 years from the issue date. To the extent that any of the options with an exercise price of $4.00 per share were not exercised by April 30, 2000, then options to purchase an equal number of shares at an exercise price of $5.00 terminated. As a result of these grants, the Company recorded compensation expense of $22,563 for the excess of the grant date fair value over the exercise price.

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(9) OTHER RELATED PARTY TRANSACTIONS

In connection with the severance agreements referred to in Notes 6 and 8 and the officer s employment agreement, a $157,190 loan to the Company s former President has been fully reserved. The Company has not released the officer from this obligation.

(10) SUBSEQUENT EVENTS

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In May 2001, the Company received $200,000 promissory note financing from Gordon Rock. Mr. Rock took a security interest in the assets of the Company. In August 2001, Mr. Rock provided an additional $150,000 promissory note financing under the same terms.

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ITEM 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

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The following discussion of the financial condition and results of operations of Burst.com, Inc. should be read in conjunction with the Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and the Notes thereto for the year ended December 31, 2000 included in the Company s Form 10-K.

CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

Some of the matters discussed in this Management s Discussion and Analysis of Financial Condition and Results of Operations, and elsewhere in this quarterly report on Form 10-Q include forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events, including, among other things:

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attracting immediate financing, merger or acquisition partners and/or a sale of assets;

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delivering quality product that meets customer expectations;

obtaining and expanding market acceptance of the products and services we offer;

responding quickly to technological challenges from third parties;

forecasts of Internet usage and the size and growth of relevant markets;

rapid technological changes in our industry and relevant markets; and

competition in our market.

In some cases, you can identify forward-looking statements by terminology such as may, will, should, could, predicts, potential, continue, expects, anticipates, future, intends, plans, believes, estimates and similar expressions. These statements are based on our current beliefs, expectations and assumptions and are subject to a number of risks and uncertainties. Actual results, levels of activity, performance, achievements and events may vary significantly from those implied by the forward-looking statements. These forward-looking statements involve risks and uncertainties that could cause our results to differ materially from those discussed. These risks and uncertainties include, but are not limited to, those described under the caption Factors That May Impact Future Results below. Additional information concerning factors that may impact future results can be found in the Risk Factors section of the above referenced S-1 Registration Statement filed on April 17, 2000. These forward-looking statements are made as of the date of this report, and except as required under applicable securities law, we assume no obligation to update them or to explain the reasons why actual results may differ.

We believe that period-to-period comparisons of its operating results, including its revenues, cost of sales, gross margins, expenses, and capital expenditures may not necessarily provide meaningful results and should not be relied upon as indications of future performance. The Company does not believe that its historical growth rates are indicative of future growth or trends.

We have incurred significant losses since its inception, and as of March 31, 2001, it had an accumulated deficit of $59,205,740. There can be no assurance that the Company will achieve or sustain profitability and the Company believes that it will continue to incur net losses in 2001.

Overview

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We are an independent provider of client/server network software for the delivery of video and audio information over networks. Our principal executive offices recently relocated to Santa Rosa, California and we have closed all other offices. Our software manages the delivery of video and audio content over various networks, including the Internet and corporate intranets, optimizing network efficiency and quality of service. Our Burstware® suite of software products enables companies to transmit video and audio files at Faster-Than-Real-Time speed, which is accomplished by utilizing available bandwidth capacity to send more video or audio data to users than the players are demanding. This data is stored on the users machine for playing on demand, thus isolating the user from noise and other network interference. The result is high quality, full-motion video and CD-quality audio to the end-user. Our revenue is derived from fees for software licenses, content hosting and other consulting services.

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Results of Operations

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Revenue recorded for the three months ended March 31, 2001 was $31,323 versus $75,012 in 2000. The revenue decline was due to curtailment of sales, support and product marketing activity occurring in November 2000. The cost of revenue recorded for the quarter ended March 31, 2001 was zero. The 2000 cost of revenue of $30,271 consisted primarily of the cost of equipment purchased from a third-party, which was resold to a customer in connection with a software sale. Resale of equipment is not part of our sales strategy, and we do not plan to make such sales to any significant degree in the future.

Research & development expenditures during the three months ended March 31, 2001 were $147,542 as compared to $933,975 during the three months ended March 31, 2000. The decrease resulted from personnel reductions and curtailment of new product development and testing. There was no significant amount of research and development that would qualify for capitalization under SFAS 86.

Sales & marketing expenses during the three months ended March 31, 2001 were $260,661 as compared to $1,727,283 during the three months ended March 31, 2000. The $1,466,622 decrease was primarily a result of staff reductions and curtailment of sales, support and product marketing activity in November 2000 and during the first quarter of 2001 as part of our restructuring.

During the three months ended March 31, 2001, general and administrative expenses were $823,752 as compared to $1,151,649 during those months in 2000. The $327,897 decrease was primarily due to the slowdown in our operations and termination of employees both in November 2000 and March 2001 as part of our restructuring. Also contributing to the decrease was a $250,000 reduction in stock-based compensation resulting from a revaluation of options for employees under variable accounting and certain unvested options being earned by contractors.

During the quarter ended March 31, 2001, due to shortage of funds, we entered into a plan to severely curtail and exit substantially all of our development and marketing operations. We closed and abandoned all of our sales offices, began a move out of our San Francisco headquarters, and laid off all but five of our remaining employees. The resulting restructuring charge of $2,705,866 represents accrued severance and leasehold costs on abandoned premises, losses and writedowns on abandoned equipment, and stock-based compensation charges related to extension of option for certain executive management personnel in connection with their severance agreements.

We had a net loss from operations of $3,906,498 during the three months ended March 31, 2001, as compared to $3,768,166 during the same three months in 2000. The increased loss resulted from the increased expenditures and charges offset by the reduction in workforce and operations discussed above.

Other expense, net was $582,761 for the three months ended March 31, 2001, as compared to $30,974 net other income for the three months ended March 31, 2000. This decline was primarily due to reduced interest income, as the January 2000 stock offering and debt conversion resulted in a significant influx of cash during that period. Cash balances during the 2001 quarter were significantly smaller. In addition, the 2001 quarter includes recognized losses of $96,817 on sales of Eagle Wireless common stock and unrecognized losses of $466,114 representing the reduction to market value of the Eagle Wireless stock remaining at March 31, 2001.

Liquidity and Capital Resources

The opinion of our independent certified public accountants on the audited financial statements for the year ended December 31, 2000 contained an explanatory paragraph regarding doubt about our ability to continue as a going concern.

Although we have been successful in our fundraising efforts to meet previous operating requirements, there can be no guarantee that we will be successful in future fundraising efforts. During the three months ended March 31, 2001, we raised $350,000 in cash by issuing notes payable and $1,166,150 in marketable securities by issuing common stock and a licensing agreement. In January 2000, we raised approximately $12,796,000 in cash, net of $1,103,000 in costs, and converted $5,335,000 of debt (including $430,000 in new debt raised in January 2000), by issuing 4,808,375 shares of our common stock. As of March 31, 2001, we had cash reserves of approximately $70,284, which will, when supplemented by proceeds of the sale of our remaining marketable securities and a subsequent issuance of $200,000 in notes payable to a stockholder-director, meet current operating requirements for approximately three months at our current spending rate, assuming no revenue. We are currently in negotiations to obtain additional outside funding through the sale of shares of our common stock in a private placement directed at both strategic and financial investors, and have recently entered into a letter of intent concerning the potential sale of substantially all of our assets. Any new funding raised may have a dilutive effect on our existing shareholders. In the event we are unsuccessful in our additional fundraising efforts and projected revenues were significantly lower than expected, we would be required to further reduce significantly cash outflows, and would be unable to restore marketing and sales activities, development, capital, and administrative expenditures resulting in decreased potential revenue and potential profitability.

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Changes in Financial Position

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As of March 31, 2001, we had a working capital deficit of $5,106,020 as compared to a deficit of $2,080,767 at December 31, 2000. This $3,025,253 decrease reflects a $131,527 decrease in current assets and an increase in current liabilities of $2,893,726. The reason for the decrease was the continued high level of administrative cost as well as lease termination costs and severance accompanying staff reductions and office closings.

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Net cash used in operating activities totaled $708,809 during the three months ended March 31, 2001, as compared to net cash used in operating activities of $3,597,479 during the three months ended March 31, 2000. In the Company s efforts to conserve cash it financed many expenditures through the expansion of accounts payable and accrued expense rather than paying currently. In addition, increases in non-cash stock-based compensation and accruals for leasehold abandonment costs and severance costs in 2001 incresased the reported loss while not actually using cash during the quarter.

Net cash provided by investing activities during the three month period ended March 31, 2001 totaled $132,509 as compared to using $426,320 during the three month period ended March 31, 2000. Investing activities in the current period consisted of disposition of property and equipment and marketable securities, while the prior period consisted of purchases.

Cash flow provided by financing activities during the three month period ended March 31, 2001 totaled $350,000 as compared to $13,270,145 during the same period in 2000. This decrease was due to the Company s fundraising efforts resulting in only minimal debt and equity financing proceeds in 2001.

Factors That May Impact Future Results

We develop complex software for media delivery, content management and storage. We have recently commenced sales of our first commercial product released late last year and have yet to achieve very large commercial deployments. Despite testing, software errors have been found in our product and, in some cases, our product s performance when initially deployed has not met customer expectations. To date, we believe that all of the errors in question have been resolved. However, there can be no assurance that other errors will not occur, as errors such as these are common in the development of any software product. Additional errors in our product could result in, among other things, a delay in recognition or loss of revenues, loss of market share, failure to achieve market acceptance or substantial damage to our reputation. As a young company that recently commenced a new product line, we face risks and uncertainties relating to our ability to implement our business plan successfully.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

At March 31, 2001 we had approximately $484,744 invested in Eagle Wireless International, Inc. common stock. The primary objective of our investment activities is to preserve our capital until it is required to fund operations while at the same time achieving a market rate of return without significant risk. However, we are limited by agreement to sell the stock in stages until June 1, 2001.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

We have no material legal proceedings against us or in process nor are we aware of any other legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse effect.

Item 2. Changes in Securities.

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Since December 31, 2000, the Company has sold the following unregistered securities. Such sales were exempt in reliance on Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder.

(a) In February 2001, we sold 1,500,000 shares of our common stock valued at $843,735 to Eagle Wireless International, Inc. in exchange for 400,000 shares of Eagle s common stock.

(b) In February 2001, we entered into two Convertible Notes payable to Draysec Finance Limited, aggregating $100,000, which Notes are convertible into a new series of Preferred Stock to be identified as Series A-2001 at a per share conversion price of $5.00 at the option of the noteholder.

(c) In March 2001, in connection with a $100,000 promissory note issued to an existing stockholder, we repriced 98,870 existing warrants and issued 50,000 new warrants to purchase an aggregrate of 148,870 shares of our common stock at $0.875 per share.

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Item 3. Defaults upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

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In May 2001, the Company received $200,000 promissory note financing from Gordon Rock. Mr. Rock took a security interest in the assets of the Company. In August 2001, Mr. Rock provided an additional $150,000 promissory note financing under the same terms.

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Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits.

4.20 Dreysec Finance Ltd. Convertible Promissory Notes

(b) Reports on Form 8-K.

None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

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BURST.COM, INC.

Date: August 15, 2001

By: /s/ Richard Lang

Richard Lang, Chairman and
Chief Executive Officer

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By: /s/ Jeffrey D. Wilson

Jeffrey D. Wilson
Chief Financial Officer

INDEX TO EXHIBITS

Exhibit Number	Description

Exhibit Number	Description
4.20	Dreysec Finance Ltd. Convertible Promissory Notes

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